S. HRG. 103-950

IMPLEMENTATION OF P.L. 100-656, THE BUSINESS OPPORTUNITY DEVELOPMENT REFORM ACT OF 1988 AND FINAL REPORT OF THE COMMISSION ON MINORITY BUSINESS DEVELOPMENT

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

ONE HUNDRED THIRD CONGRESS

SECOND SESSION

ON

HEARING ON IMPLEMENTATION OF P.L. 100-656, THE BUSINESS OPPORTUNITY DEVELOPMENT REFORM ACT OF 1988 AND FINAL REPORT OF THE COMMISSION ON MINORITY BUSINESS DEVELOPMENT

WEDNESDAY, JULY 27, 1994

Printed for the use of the Committee on Small Business

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IMPLEMENTATION OF PUBLIC LAW 100–656, THE BUSINESS OPPORTUNITY DEVELOPMENT REFORM ACT OF 1988 AND FINAL REPORT OF THE COMMISSION ON MINORITY BUSINESS DEVELOPMENT

WEDNESDAY, JULY 27, 1994

U.S. SENATE,
COMMITTEE ON SMALL BUSINESS,
Washington, D.C.

The Committee met, pursuant to notice, at 2:06 p.m., in room SR–428A, Russell Senate Office Building, Hon. Dale Bumpers, Chairman of the Committee, presiding.

OPENING STATEMENT OF HON. DALE BUMPERS, U.S. SENATOR FROM THE STATE OF ARKANSAS

The CHAIRMAN. In the interest of time, and because Senator Kerry has to leave to go to the Banking Committee for hearing—he would be better off to stay here—I will insert my statement in the record and we can save that much time.

[The prepared statements of Senator Bumpers and Senator Heflin follow:]

Committee on Small Business
UNITED STATES SENATE

HEARING

on

Implementation of P.L. 100-656,
the "Business Opportunity Development Reform Act of 1988"
and
the Final Report of the Commission on Minority Business Development

July 27, 1994

STATEMENT of SENATOR DALE BUMPERS

This afternoon the Committee on Small Business meets to receive testimony on the implementation of Public Law 100-656, the "Business Opportunity Development Reform Act of 1988", the last major Congressional effort to reform the SBA's minority business development program. Most people know this program as the Section 8(a) program, which provides authority for the preferential award of contracts. Prior to 1988, hearing after hearing, study after study, convinced us that the program's focus on sole source contracting and the absence of coordinated business development support were at the rootof the program's disappointing results.

In 1987, we faced the program's most notorious scandal -- Wedtech. The 1988 reforms sought to address identified shortcomings as much as to prevent future abuses. Today, we will hear the extent to which we succeeded or failed in these two goals.

We'll hear from representatives of the General Accounting Office. Faced with earlier failed efforts at obtaining intended reform, the 1988 legislation directed GAO to monitor the Act's implementation. The GAO has issued two reports, the results of which were more than a little discouraging.

The first GAO report, ***Problems in Restructuring SBA's Minority Business Development Program***, issued in January 1992, was grim. It cataloged numerous, serious problems. Let me cite but a few examples. Program applications were still not being timely processed, something members of this Committee heard about frequently from constituents. The report showed limited implementation of the reform Act's several provisions directly aimed at improving an 8(a) firm's prospects for success after graduation. The Act, for example, sought to improve prospects for success by

gradually reducing the Program Participant's dependence on 8(a) contracts, especially non-competitively awarded 8(a) contracts, as the firm approached the end of its nine-years in the Program.

The 1988 legislation also intended to bring competition to the award of higher dollar value 8(a) contracts, both to enhance the competitive skills of Program Participants and to reduce the potential for wrongdoings like those revealed in the investigations of abuses by, and for, the Wedtech Corpoaration. But the goal of competitive 8(a) contract awqrds remains elusive.

Congress also sought to ensure more contract participation by the smaller Program Participants. Ever since the first major review of 8(a) contracting in 1981, the top 50 firms have consistently won between 35 and 40 percent of dollars awarded through 8(a). Unfortunately, this situation has also remained unchanged.

Finally, GAO reviewed SBA's management system, or more accurately, its lack of an effective management system for the minority business development program. This lack of an effective information management system may even frustrate the most thoughtful efforts to implement reform, statutory or otherwise.

During the House hearing on the GAO's first report, conducted in March 1993, they were we requested to do follow-up work. GAO's second report issued in September 1993 is entitled ***Problems Continue With SBA's Minority Business Development Program***. Unfortunately, this title is all too accurate. Administrator Bowles promised a comprehensive proposal to change the program's direction. SBA has completed and issued that proposal for a new Minority Enterprise Development (MED) Program, but to be successful it must address the persistent problems that will be reviewed again today. We will hear from SBA about the MED Program at a subsequent legislative hearing on the "Business Development Opportunity Act of 1994", being proposed by Senator Kerry.

GAO's testimony today bears an ominous title, ***SBA Cannot Assess the Success of Its Minority Business Development Program***. The testimony will demonstrate how seemingly intractable many of these problems are. It also highlights the absolute need for an effective program management system.

Next, we will have testimony from the Inspectors General of SBA and the Department of Defense. Both have done important audit work regarding 8(a) contracting. As the Committee will hear, the problems identified are serious. The IG's make clear that there has been almost a concerted effort to circumvent the 1988 reform Act's requirements for the competitive award of 8(a) contracts above the statutory thresholds. Their testimony will show that the 8(a) contracting process is still being used to subvert generally applicable requirements relating to Government contracts, especially the requirement for full and open competition or the justification and approval of non-competitive awards. As will be described, some 8(a) contractors are merely functioning as "brokers" through excessive subcontracting. These are abuses that cannot be permitted to continue.

So that this hearing should not conclude on a pessimistic note, today's final witness will be Joshua Smith, Chairman and Chief Executive Office of The MAXIMA Corporation. Mr. Smith served as the Chairman of the Commission on Minority Business Development, created by the 1988 reform legislation. Over a 30-moth period, the Commission

conducted a comprehensive review and assessment of the existing Federal programs to foster minority business development. He will share with us the major recommendations of the Commission's Final Report. And, I expect, he will share with the Committee his firm belief that America's success in the 21st Century will be advanced through broader minority business participation in all segments of our Nation's economy.

I welcome today's witnesses, look forward to their testimony, want to thank each of them for making time to be with us today.

STATEMENT BY SENATOR HOWELL HEFLIN
BEFORE THE SENATE SMALL BUSINESS COMMITTEE
ON THE MINORITY BUSINESS DEVELOPMENT PROGRAM

July 27, 1994

Mr. Chairman, the stated objective of the Small Business Administration's 8(a) Program is to assist a minority-owned company to develop to the point where it has the skills and infrastructure necessary to thrive in the mainstream economy. Despite this noble and well-intentioned objective, I am afraid the program is not graduating enough viable minority-owned firms. Of the 100 firms participating in the 8(a) Program in Alabama, 20% are either going out of business or have been recommended for termination, and many of the remaining 80% are just treading water.

Therefore, I believe it is entirely appropriate that we revisit the "Business Opportunity Reform Act of 1988" in order to make the corrections needed to graduate a greater percentage of minority-owned firms that can survive in the marketplace, and the best place to look for suggestions on ways to make the program better is to those who have been participating under the 1988 rules and regulations. Without wading too deep into this technical issue, I would like to briefly share some of the suggestions my 8(a) constituents in Alabama have given me on how best to reform the program.

First of all, elimination of the mandatory business mix, according to my 8(a) constituents, is essential. All companies that intend to stay in business over the long-haul have obvious motivation to become competitive and seek non 8(a) work, but

schedules and economic conditions impact various industries differently. The individual company should be, and usually is, the best judge of their business viability.

In addition, many of the 8(a)s in Alabama would like to see the fixed ceiling support level eliminated, particularly 8(a)s in high tech industries. Companies should be able to receive whatever has been self marketed and the consumer feels comfortable with awarding on a sole-source basis.

Finally, I think it appropriate that we consider extending the participation period for the current generation of 8(a) participants--a generation that has been operating under the cumbersome and ineffective regulations of the "Business Opportunity Reform Act of 1988." If the objective of the 8(a) Program is to graduate viable minority-owned businesses, it is essential that we extend the participation period for the current generation of participants. After six years of operating under the 1988 legislation, efforts are finally being made to correct the shortcomings made evident over the past six years. It is important to remember, however, that the road to reform has been paved with the blood, sweat and tears of current 8(a) participants. It is only right that we allow those who discovered the bumps in the road, the opportunity to benefit from the lessons learned on their watch.

In closing, I look forward to working with Senator Kerrey on his 8(a) reform legislation which I understand he will soon introduce, and I appreciate the opportunity to address this important matter on behalf of all 8(a)s in Alabama.

STATEMENT OF HON. JOHN F. KERRY, U.S. SENATOR FROM MASSACHUSETTS

Senator KERRY. Mr. Chairman, thank you very much. I apologize for the fact that I will not be here for the full meeting, but we have a preparatory meeting for some hearings, and unfortunately, I must be there.

Mr. Chairman, I really appreciate your holding this hearing and I very much appreciate the work that you and your staff have done, together with my staff and Senator Wofford's, Senator Lieberman, Senator Boren, and others, in order to try to address some of the questions about the 8(a) program. We want to maximize the testimony here so I am not going to make a long opening statement by any sense of the imagination.

I would just say very quickly that we have visited this issue before. In 1988, we passed what we thought was a reform effort, and it was supposed to be for small business development and opportunity. Regrettably, as you know better than anybody, Mr. Chairman, the SBA itself was under attack for a number of years, being zero-budgeted almost perennially, and the capacity to implement the reforms that we passed was greatly complicated by virtue of those attitudes, as well as by some preconditioned attitudes about entrepreneurial efforts within the minority community itself.

We now know from IG reports and other reports that the problems are not limited to businesses that have stayed on the program for 9, 10 or even 11 years. The problem now is that there is evidence of some fraud in the program with respect to a pass-on scheme where businesses front as minority enterprises but in fact are simply passing on the business, and that is obviously not what it was intended for.

I am convinced, and I think others are convinced, that notwithstanding the fact that we have visited these issues before, we can improve this program and we can hold on to the best of what it is supposed to do. To that effect, we have been working with you, Mr. Chairman, to develop legislation that will hopefully address the concerns that have existed about paperwork burdens, contracting, lack of training and lack of capacity to be weaned from the program. However, at the same time we want to hold on to what we think is a very essential effort in helping disadvantaged communities gain a share of the marketplace and to do so in a way that helps take the Federal dollar, leverage these enterprises, and then move them out onto their own. We think that many of the remedies set forth in the draft legislation have a potential of doing that.

Mr. Chairman, I know your own concerns are deep about the capacity of this program to work, and I know you have reservations, as others do, about the road that has been traveled. But I am convinced, and I think some of the testimony will show, that a large part of the continuing problem is not due to inherent fallacies in the concept itself but rather due to the fact that reform was never implemented. The program was never truly taken to that plateau that we tried to reach in 1988, and hopefully, now with the new administration, with a new attitude, and with some remedies that are fashioned on our current understanding of the problems, we can address those concerns.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Kerry.

Our first panel this afternoon consists of one witness, Jacquelyn L. Williams-Bridgers, Associate Director, Housing and Community Development Issues, with the GAO. Welcome, Ms. Williams-Bridgers, and please proceed.

STATEMENT OF JACQUELYN L. WILLIAMS-BRIDGERS, ASSOCIATE DIRECTOR, HOUSING AND COMMUNITY DEVELOPMENT ISSUES, RESOURCES AND COMMUNITY DEVELOPMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE; ACCOMPANIED BY STANLEY RITCHICK AND RICHARD SMITH

Ms. WILLIAMS-BRIDGERS. Thank you very much, Senator and members of the Committee. We are pleased to be here today to discuss the Small Business Administration's progress in implementing changes to the 8(a) business development program that were mandated by the Business Opportunity Reform Act of 1988. This Act was designed to direct SBA's attention to what at the time were troubling program results, indicating that few firms leaving the 8(a) program could compete successfully in the commercial marketplace.

To remedy this problem, the Act required SBA to, among other things, develop and implement a systematic process for collecting 8(a) program data, to obtain revised business plans from 8(a) firms so that SBA can better monitor their development, and to annually review each business plan and to competitively award certain 8(a) contracts.

As you recall, Mr. Chairman, in 1992 and again in 1993, we reported to the Congress a number of difficulties SBA was experiencing in implementing these changes, including SBA's lack of reliable program data needed to manage and assess the 8(a) program, and problems that hampered development of a management information system.

Our testimony today will once again focus on SBA's progress in implementing key features of the 8(a) program that are designed to make an effective business development program. In addition, we will discuss SBA's progress in implementing its management information system, which we view as essential to the Agency's ability to evaluate 8(a) programs' effectiveness.

SBA has made some improvements in its administration of certain aspects of the 8(a) program, but it is still not well-positioned to assess the overall success of its minority business development effort. Specifically, our analysis indicates that while the value of 8(a) contracts competitively awarded during fiscal year 1992 exceeded the value of those awarded during fiscal year 1991, the distribution of contracts continues to be concentrated among a very small percentage of 8(a) firms.

Also, while SBA has approved new or revised business plans for most 8(a) firms, SBA could not tell us whether these plans are being annually reviewed, as required by the Act, or whether the firms are achieving the non-8(a) contract goals that were established to reduce their reliance on the 8(a) program.

Finally, SBA's failure to properly plan the redesign of the program's management information systems continues to hamper the

implementation of the only tool available to SBA's program managers to provide the data necessary to measure the 8(a) program's progress, as well as evaluate the effectiveness of program efforts to develop viable businesses.

Let me begin with discussion of 8(a) competitively- awarded contracts. To help develop firms and better prepare them to compete in the commercial marketplace after they leave the program, 8(a) contracts must be awarded competitively when the total contract price, including the estimated value of contract options, exceeds $5 million for manufacturing contracts and $3 million for all other contracts. As shown in this first table on page 5 of my prepared testimony, the number of 8(a) contracts and contract dollars awarded increased between fiscal years 1991, 1992, and 1993. As shown in the bottom line of that table, the percent of contract dollars awarded competitively between fiscal years 1991 and 1992 increased from 13 percent to 20 percent.

Data was not readily available from SBA to allow us to determine whether the percentage of new contract dollars awarded competitively also increased between FY 1992 and FY 1993.

The CHAIRMAN. Ms. Williams-Bridgers, let me interrupt you for just a moment now. As I read this, less than 5 percent of the contracts that were awarded were awarded competitively, but 20 percent of the total dollars were awarded competitively. Is that correct?

Ms. WILLIAMS-BRIDGERS. That is correct, sir.

The CHAIRMAN. Well now, do you find that good or bad?

Ms. WILLIAMS-BRIDGERS. What that is telling us is that the average value of the contracts awarded to the firms may be decreasing over time. Whether or not that is good or bad is difficult for us to say at this time without additional information.

The CHAIRMAN. I ask you because we would anticipate that. You know, competitive contracts are the bigger ones.

Ms. WILLIAMS-BRIDGERS. Yes.

The CHAIRMAN. So you expect those to amount to more in dollar value than the ordinary 8(a) contract. So this is in line with one of the things that we wanted to do under the reforms of 1988?

Ms. WILLIAMS-BRIDGERS. You will also note in this table that 86 new contracts were competitively awarded in FY 1991, and 139 contracts were awarded in FY 1992. We are not able to tell you in 1992 and 1993, when we first reported these results how many contracts actually exceeded the competition thresholds, and therefore should have been competitively awarded. This is because SBA's management information system did not record the total estimated cost of the contracts, including the value of any contract options that might be exercised over time.

According to SBA, the 8(a) program management information system still has this limitation. Consequently, program managers cannot rely on their management information system to determine the extent to which contracts that meet the competitive thresholds are not being awarded competitively.

In the 1988 Reform Act, Congress directed SBA to promote the equitable distribution of noncompetitive 8(a) contracts to correct the inequitable situation of a few firms receiving the bulk of 8(a) contracts. As early as 1981, we reported that on average 50 8(a)

firms annually received about 31 percent of all 8(a) contracts over a 12-year period. The concentration of 8(a) contracts among a relatively few firms has been a long-standing condition, a condition that is continuing today, as is shown in the chart on page 7 of my prepared testimony.

In fiscal year 1992, 50 firms, or about 1 percent of all participating 8(a) firms, received 31 percent of the nearly $4 billion in 8(a) contracts awarded that year. In fiscal year 1993, 50 firms, or about the same percentage, 1 percent, of the 8(a) firms, received 25 percent of the $4.3 billion in 8(a) contracts awarded that fiscal year. As of June of this year, once again about 1 percent of the firms received about 33 percent of the contract dollars awarded to date.

The CHAIRMAN. Are those mostly local firms, Maryland, Virginia, D.C.?

Ms. WILLIAMS-BRIDGERS. They are among the top States with the most firms, that is correct, sir.

To view the issue of concentration from a slightly different perspective, more than one-half of the 8(a) firms have not received any contracts since fiscal year 1991. In fiscal year 1991, about 45 percent of the then 3900 participating firms got contracts, while 55 percent did not receive any contracts. Up until fiscal year 1993, about 46 percent of the 4800 firms received contracts, while 54 percent did not.

Senator KERRY. What conclusion do you draw from that?

Ms. WILLIAMS-BRIDGERS. Well, one of the unknowns here is whether or not many of the 8(a) firms are receiving certification merely to compete at the State and local level. Many of the 8(a) firms may not ever intend to receive Federal procurement contracts. But we do not know. We do not know what is happening with those firms that have not been pursuing 8(a) contracts. It may be that some are not self-marketing SBA.

Senator KERRY. Do you read anything else into those distribution figures? Does that tell you anything else? Is there another story there?

Ms. WILLIAMS-BRIDGERS. No, because we have to understand what is happening with the firms that are not receiving the 8(a) contracts. There are a lot of unknowns, and that is something that needs to be pursued for us to find out whether or not the firms are receiving the appropriate skills, if they are receiving the appropriate types of management and technical assistance from 8(a) and others to help them pursue Federal procurement contracts, which you would assume would be the desired aim of certification in 8(a) given its fairly burdensome certification process.

Another fundamental tenet of the 8(a) Reform Act was that the 8(a) program focus its attention on business development. The preparation of business plans helped to develop 8(a) firms by setting forth, among other things, the firms' business development goals and objectives, estimates of future 8(a) and non-8(a) contract activity, and specific steps for ensuring profitable business operations after the firm completes its term in the 8(a) program. The 1988 Act also requires SBA to annually review each business plan with the firm and modify the plan as needed to ensure the firm's business development goals are realistic and to help the firm achieve them.

In September 1993 we reported that SBA had approved the business plans of about 88 percent of the firms, and the 12 percent of the firms without approved business plans were either relatively new or not receiving 8(a) contracts or in the process of being terminated from the program. However, we also reported that SBA often was not conducting annual reviews of approved business plans, as required by the Act, and the emphasis given to annual reviews varied among SBA offices.

As of this month, about 80 percent of the then 5300 firms in the program had new or revised business plans approved by SBA. At the same time, SBA headquarters could not tell us whether these plans are being annually reviewed or being modified to better reflect the firm's business development goals and objectives, because program managers do not routinely collect this information from their field offices. Consequently, program managers cannot readily determine whether 8(a) firms are being directed towards successful operation and successful transition from the 8(a) program.

To help ensure that firms do not develop an unreasonable reliance on 8(a) contracts as they approach the end of their 9-year term in the program, SBA established levels of increasing non-8(a) business activity that firms in the last 5 years of their program term must achieve. These levels range from a minimum of 15 percent of a firm's revenue during the firm's 5th year to a minimum of 55 percent in its 9th and final year.

SBA field offices, as part of their annual reviews of the firms in the program, are responsible for ensuring that firms comply with their non-8(a) contract levels. However, SBA could not provide us with any information about the extent to which 8(a) firms are meeting their non-8(a) business goals because they do not routinely collect this information from their field offices. As a result, program officials do not know the extent to which firms are achieving these levels and reducing their overall reliance on the 8(a) program contracts.

We are encouraged that SBA is attempting to develop a systematic process for collecting program data as well as monitoring and evaluating the 8(a) firms' progress. Last year, however, we reported that SBA's initial efforts to redesign its management information system were not planned in accordance with Federal regulations. Specifically, we found that a determination that defines the system's requirements in relation to SBA's mission was not complete, that an analysis of various alternative system designs, including costs and benefits of each, was not performed, and that SBA's overall plan for implementing the system was not complete nor did it have cost estimates for the redesign effort. We also reported that SBA's latest time estimate for completing the system redesign was late 1995, 5 years later than it had originally planned.

Last week, SBA gave us information that indicates its failure to properly plan the redesign effort continues to delay the implementation of a system capable of providing management with fundamental 8(a) program information. Without such a system, the Congress and SBA cannot determine what assistance is being provided to 8(a) firms, assess the effectiveness of such assistance, and more importantly, assess the program's overall effectiveness in developing 8(a) firms.

SBA officials also told us last week that they still do not have any estimates of the time or total cost to complete the redesign of the 8(a) management information system. SBA estimates that as of June 1994 it had spent $1 million on the redesign effort. In fiscal year 1994, SBA had targeted $950,000 in discretionary funds to complete the redesign effort. However, $600,000 was reprogrammed to meet unanticipated salary and benefit requirements throughout SBA. Of the remaining $350,000 that could be spent on the redesign effort, only $17,500 had been expended as of June 1994.

Last September, the SBA Administrator estimated that it would take SBA up to 2 years to complete the redesign of the management information system. However, because of the problems that SBA continues to experience in its development efforts and the limited funding that it has committed to the redesign effort in fiscal year 1994, we are concerned that the kinds of delays experienced in the past will continue in the future.

In summary, Mr. Chairman, while SBA has made some progress in improving aspects of the 8(a) program, it still is not in a position to assess the program's success in developing minority-owned businesses that can compete on equal bases in the mainstream of the Nation's economy. The value of 8(a) contracts awarded competitively increased in fiscal year 1992, but there has been no improvement over the past 5 to 6 years in the dispersion of contracts among 8(a) firms. In addition, while SBA has over the past few years consistently reviewed firms' new and revised business plans, program managers here in Washington cannot assess whether the types of assistance it provides is consistent with the developmental needs of firms over time, because SBA does not know whether firms are meeting their business goals.

Also, despite the investment of several years' effort and approximately $1 million, SBA's management information system still is unable to provide the most basic data needed to manage the 8(a) program and to evaluate its effectiveness in developing business and competitive skills of firms. Program managers do not know whether firms nearing the end of their 8(a) program terms have acquired competitive skills or sufficient numbers of non-8(a) contracts to provide them a reasonable chance of success in the commercial marketplace.

Our position has been, and it continues to be, that to effectively manage and assess the 8(a) program or any new program that may be proposed to replace it, SBA must have knowledge of the firms' overall growth as well as the program's ability to provide the contracting opportunities and the management assistance necessary to develop these firms. This information can be obtained with the implementation of an effective management information system. However, such a system is not yet in place at SBA.

This concludes my prepared statement. I am joined at the table by Stanley Ritchick and Richard Smith, the managers of our 8(a) program evaluations. We would be glad to respond to any questions that you or members of the Committee may have.

[The prepared statement of Ms. Williams-Bridgers follows:]

United States General Accounting Office

GAO

Testimony

Before the Committee on Small Business,
United States Senate

For Release on Delivery
Expected at
2 p.m. EDT
Wednesday
July 27, 1994

SMALL BUSINESS

SBA Cannot Assess the Success of Its Minority Business Development Program

Statement of Jacquelyn Williams-Bridgers,
Associate Director
Housing and Community Development Issues,
Resources, Community, and Economic Development Division

GAO/T-RCED-94-278

Mr. Chairman and Members of the Committee:

We are pleased to be here to discuss the Small Business Administration's (SBA) progress in implementing changes to its 8(a) business development program that were mandated by the Business Opportunity Development Reform Act of 1988. This program provides federal contracts to small businesses that are owned and controlled by socially and economically disadvantaged individuals to help the firms develop their business and competitive skills and become viable businesses. Firms in the program are eligible to receive financial, technical, and management assistance from SBA to aid their development.

The Congress enacted this act[1] because it found that few firms leaving the 8(a) program could compete successfully in the commercial marketplace. The Congress also found that gaining access to the program was a lengthy and burdensome process, and program administration was inefficient. To remedy these problems, the act made a number of changes to the program, including requiring SBA to (1) develop and implement a systematic process for collecting 8(a) program data, (2) obtain revised business plans from 8(a) firms so that SBA can better monitor their development, and to annually review each business plan, and (3) competitively award certain 8(a) contracts.

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[1]"Act" refers to both the 1988 legislation and subsequent technical amendments enacted in June 1989.

As you may recall, Mr. Chairman, our January 1992 and September 1993 reports discussed the difficulties SBA was experiencing in implementing the act's changes, the agency's lack of reliable program data needed to effectively manage the program, and its problems in developing an effective management information system.[1] The Congress will soon consider proposals by SBA and others to change the program. Our testimony today may assist the Congress in this effort in that it focuses on SBA's progress in implementing key features of the program that are designed to make it an effective business development program. These are (1) requiring the competitive award of large-dollar-value 8(a) program contracts, (2) distributing 8(a) contracts so that a larger number of firms receive them, (3) improving business planning by 8(a) firms, and (4) requiring 8(a) firms to achieve certain levels of non-8(a) contract dollars as they progress toward program completion. We will also discuss SBA's activities relating to redesign of its management information system.

In summary, Mr. Chairman, while SBA has made progress in improving some aspects of the 8(a) program, it still is not in a position to evaluate the program's overall success in developing minority businesses that can compete in the commercial marketplace after they leave the program. While the value of 8(a) contracts

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[1] Small Business: Problems in Restructuring SBA's Minority Business Development Program (GAO/RCED-92-68, Jan. 31, 1992) and Small Business: Problems Continue With SBA's Minority Business Development Program (GAO/RCED-93-145, Sept. 17, 1993).

awarded competitively during fiscal year 1992 exceeded the value of the contracts awarded competitively during fiscal year 1991, the distribution of contracts continues to be concentrated in a very small percentage of 8(a) firms. Also, while SBA has approved new or revised business plans for most 8(a) firms, it could not tell us whether these plans are being annually reviewed, as required by the act, and/or whether the firms are achieving the non-8(a) contract goals agreed upon by the firms and SBA to reduce the firms' reliance on program contracts. Finally, the information that SBA gave us shows that its failure to properly plan the redesign of the program's management information system continues to hamper the implementation of a system capable of providing SBA program managers with fundamental 8(a) program information. The need for information on program results has been reinforced with the enactment of the Government Performance and Results Act of 1993, which requires that selected federal agencies, including SBA, develop the information necessary to make objective evaluations of program performance.

BACKGROUND

The 8(a) program, administered by SBA's Office of Minority Enterprise Development,[3] is the federal government's principal vehicle for developing small businesses that are owned by

[3]This office was formerly the Office of Minority Small Business and Capital Ownership Development.

minorities and other socially and economically disadvantaged individuals. As of July 21, 1994, there were 5,352 firms in the 8(a) program. In fiscal year 1993, 5,462 new contracts and 20,404 contract modifications, together totaling $4.3 billion, were awarded to 8(a) firms.

The Congress has made three major legislative attempts--in 1978, 1980, and 1988--to improve SBA's administration of the 8(a) program and to emphasize its business development aspects. Over the years, reports by GAO, SBA's Inspector General, and others have shown continuing problems with SBA's administration of the program and/or with the program's ability to develop firms that could compete in the commercial marketplace after leaving the program. Problems often cited in these reports were that a large percentage of the total number of contracts was being awarded to very few 8(a) firms, and that SBA lacked the data needed to effectively manage the 8(a) program. These reports made numerous recommendations for improving the 8(a) program. Mr. Chairman, our September 1993 report, copies of which are available today, provides a synopsis of selected reports issued on the 8(a) program since 1975.

8(a) COMPETITIVELY AWARDED CONTRACTS INCREASED

To help develop firms and better prepare them to compete in the commercial marketplace after they leave the program, 8(a) program contracts must be awarded competitively when the total

contract price, including the estimated value of contract options, exceeds $5 million for manufacturing contracts or $3 million for all other contracts.

As shown in the table below, the percentage of contract dollars awarded competitively increased between fiscal years (FY) 1991 and 1992. While the total number of contracts and contract dollars increased in fiscal year 1993, data were not available to determine the percentage of contract dollars awarded competitively during fiscal year 1993.

Table 1: Percent Increase in Competitive Contract Dollars Since 1991 (Dollars in Billions)

8(a) contracts	FY 1991	FY 1992	FY 1993
Number of contracts awarded	4,576	4,693	5,462
Number of contracts awarded competitively	86	139	N/A
Contract dollars awarded	$1.60	$1.70	$2.20
Contract dollars awarded competitively	$0.21	$0.34	N/A
Percent of contract dollars awarded competitively	13	20	N/A

N/A - Not Available.

Source: SBA.

In both our 1992 and 1993 reports, we noted that we were unable to determine how many of the new 8(a) contracts should have been awarded competitively because SBA's management information system did not record the total estimated cost of the contracts, including the value of any contract options that might be exercised in the future. According to SBA, the 8(a) program management information system still has this limitation. Consequently, SBA program managers cannot rely on the management information system for information on the extent to which contracts that meet the competitive thresholds are not being awarded competitively.

8(a) CONTRACTS STILL CONCENTRATED IN SMALL PERCENTAGE OF FIRMS

The act directs SBA to promote the equitable distribution of noncompetitive 8(a) contracts to the maximum extent possible. The Congress adopted this provision to correct the inequitable situation of a few firms receiving the bulk of 8(a) contracts. However the concentration of 8(a) contracts among a relatively few firms is a long-standing condition that is continuing. As early as 1981, we reported that, on average, 50 8(a) firms annually received about 31 percent of all 8(a) contract awards over a 12-year period.[4] In recent years, we reported that

[4]The SBA 8(a) Procurement Program--A Promise Unfulfilled (CED-81-55, Apr. 18, 1981).

-- in fiscal year 1990, 50 firms--less than 2 percent of the 3,645 firms in the program--received about $1.5 billion, or 40 percent of the nearly $4 billion in 8(a) contracts awarded, and

-- in fiscal year 1992, 50 firms--about 1 percent, of the 4,291 firms in the 8(a) program--received about $1.15 billion, or about 31 percent of the $3.67 billion in 8(a) contracts awarded.

More recently, SBA data show that

-- in fiscal year 1993, 50--about 1 percent of the 4,848 firms in the 8(a) program--received about $1.08 billion, or 25 percent of the $4.33 billion in 8(a) contracts awarded, and

-- in fiscal year 1994, 50 firms--about 1 percent of the 5,382 firms in the program--accounted for $742 million, about 33 percent of the $2.28 billion in 8(a) contracts awarded as of June 1994.

Conversely, about half of the 8(a) firms have not received any contracts since fiscal year 1990. According to SBA, of the 4,848 firms in the 8(a) program at the end of fiscal year 1993, 2,607 firms, or 54 percent, did not receive any program contracts during

the fiscal year. This compares to 54 percent of the firms in the program at the end of fiscal year 1992, 55 percent at the end of fiscal year 1991, and 53 percent at the end of fiscal year 1990 that did not receive any 8(a) program contracts during each of those fiscal years. It should be noted, however, that some firms seek SBA certification as an 8(a) firm solely for the purpose of qualifying and obtaining contracts from sources not associated with the 8(a) program. However, SBA does not know the extent to which this is occurring.

COMPLIANCE WITH REQUIREMENT FOR ANNUAL BUSINESS PLAN REVIEWS CANNOT BE DETERMINED

Business plans help to develop 8(a) firms by setting forth, among other things, the firm's business development goals and objectives, estimates of its future 8(a) and non-8(a) contract activity, and specific steps for ensuring profitable business operations after the firm completes its term in the program. The 1988 act requires SBA to annually review each business plan with the firm and modify the plan, as needed, to ensure that the firm's business development goals are realistic and to help the firm achieve them.

In September 1993, we reported that SBA had approved the business plans of about 88 percent of 8(a) firms and that the 12 percent of firms without approved business plans were either

relatively new, not receiving 8(a) contracts, or in the process of being terminated from the program. However, we also reported that SBA was not conducting annual reviews of approved business plans as required by the act and that the emphasis given to annual reviews varied among SBA offices. Our September 1993 report noted, for example, that SBA's Philadelphia District Office staff had not conducted annual business plan reviews for 8 of the 15 8(a) firms whose files we reviewed because the staff had placed a low priority on such reviews. Conversely, staff in SBA's New Orleans District Office had conducted annual business plan reviews for all 13 of the 8(a) firms whose files we reviewed.

SBA's data as of July 21, 1994, show that 4,282, or about 80 percent, of the 5,352 firms in the program had new or revised business plans approved by SBA. At the same time, SBA headquarters could not tell us whether these plans are being annually reviewed and/or are being modified to better reflect the firms' business development goals and objective because it does not routinely collect these data from the field offices. However, SBA officials told us that there is a need for this information and SBA plans to direct its field offices to provide it.

COMPLIANCE WITH 8(a) AND NON-8(a) CONTRACT TARGETS UNKNOWN

To help ensure that firms do not develop an unreasonable reliance on 8(a) contracts as they approach the end of their 9-year term in the program, SBA established levels of increasing non-8(a) business activity that firms in the last 5 years of their program term must achieve. These levels range from a minimum of 15 percent of a firm's revenues during the firm's fifth year to a minimum of 55 percent in its ninth and final year.

SBA field offices, as part of their annual reviews of firms in the program, are responsible for ensuring that firms comply with their non-8(a) contract levels. However, SBA headquarters could not provide us with any information about the extent to which 8(a) firms are meeting their non-8(a) business levels because SBA does not routinely collect this information from its field offices. As a result, SBA program officials do not know the extent to which firms are achieving these levels and reducing their overall reliance on 8(a) program contracts.

REDESIGN OF 8(a) PROGRAM'S MANAGEMENT INFORMATION SYSTEM CONTINUES TO EXPERIENCE DELAYS

SBA is attempting to develop a systematic process for collecting program data as well as tracking, monitoring, and

evaluating 8(a) firms' progress. In January 1992, we reported that SBA's 8(a) program management information system did not provide SBA with the data needed to effectively manage the program and that SBA, recognizing these inadequacies, had begun a four-phased approach to redesign the system.

However, in our September 1993 report, we stated that SBA's initial efforts to redesign the system were not planned in accordance with federal regulations and guidelines. Specifically, (1) a needs determination that defines the system's requirements in relation to SBA's mission was not completed; (2) an analysis of various alternative system designs, including the costs and benefits of each, was not performed according to federal requirements; and (3) SBA's overall plan for implementing the system did not outline software, hardware, and telecommunications requirements, describe how the related systems would be interfaced and integrated, or provide a schedule and cost estimates for the redesign effort. We also reported that SBA had not estimated the total cost of redesigning this system and that SBA's latest time estimate for completing the system redesign was late 1995, 5 years later than it had originally planned.

Mr. Chairman, information SBA gave us shows that its failure to properly plan the redesign effort continues to delay the implementation of a system capable of providing management with basic 8(a) program information. Without such a system, we believe

the Congress and program managers cannot determine what assistance is being provided to 8(a) firms, assess the effectiveness of such assistance, or most importantly, assess the program's overall effectiveness in developing 8(a) firms.

SBA's management information system redesign consists of four phases--the Certification Tracking System, the Servicing and Contracting System, the Management and Technical Assistance System, and the Central Office Repository System. The Certification Tracking System is intended to provide SBA with information on the initial 8(a) program applications and on other eligibility issues, such as graduations and withdrawals from the 8(a) program. Currently, this system is capable of generating routine reports on the number and status of applications, but it still lacks the capability to provide program managers with information on the other eligibility issues.

The Servicing and Contracting System, which is intended to assist field office personnel in servicing 8(a) firms and monitoring contracts, was originally to be implemented in September 1992. The system component for servicing 8(a) firms was implemented in a selected number of field offices in September 1993. Although this component was pilot-tested before being implemented, a May 1994 SBA survey of field office personnel identified a number of major design flaws that, according to SBA, must be corrected if the system is to be a viable work tool and not

an impediment to productivity. For example, field office personnel reported that the system is too slow, too difficult to use, and limited in the types of data it will accept. In addition to correcting the flaws in this component of the system, SBA must complete the development of the system component that will provide information on 8(a) contract requirements and awards.

The Management and Technical Assistance System is intended to help SBA record, track, and report on management and technical assistance provided to 8(a) firms. In September 1992, SBA entered into a year-long contract, valued at approximately $100,000, to develop this system. During the fall of 1993, this system was delivered to SBA for testing. As a result of this and other testing, SBA considers the system unacceptable and must now decide whether to reject the system or spend additional funds to make it acceptable.

The Central Office Repository System, the final phase of the redesign, is intended to (1) accumulate data at the national level and (2) provide SBA with the capability to write reports for all program areas and automated subsystems. However, SBA is considering building these two functions directly into each of the aforementioned systems, obviating the need for this final system.

Mr. Chairman, SBA officials told us last week that they still do not have any estimates of the time or total cost to complete the

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redesign of the 8(a) program's management information system. SBA estimates that as of June 1994, it had spent about $1 million on the redesign effort. In fiscal year 1994, SBA had targeted $950,000 in discretionary funds to complete the redesign work. However, $600,000 was reprogrammed to meet unanticipated salary and benefit requirements. Of the remaining $350,000 that could have been spent on the redesign work, only about $17,500 had been expended as of June 1994.

Last September, the SBA Administrator estimated that it would take SBA up to 2 years to complete the redesign of the management information system. However, because of the problems that SBA continues to experience in its development efforts and the limited funding committed to the redesign effort in fiscal year 1994, we are concerned that the kinds of delays experienced in the past will continue in the future.

SUMMARY

In summary, Mr. Chairman, while SBA has made progress in improving some aspects of the 8(a) program, it still is not in a position to evaluate the program's overall success in developing minority businesses that can compete in the commercial marketplace after they leave the program. The value of 8(a) contracts awarded competitively increased in fiscal year 1992, but there has been no improvement over the last 5 to 6 years in the dispersion of

contracts among 8(a) firms. SBA has over the past several years paid considerable attention to firms' new or revised business plans, but program managers cannot assess whether the business assistance SBA provides to the firms is consistent with their development needs because SBA does not know from one year to the next whether firms are meeting their own business development goals.

Also, despite the investment of several years of effort and approximately $1 million, SBA's management information system still is unable to provide the most basic data needed to manage the 8(a) program and to evaluate its effectiveness in developing the business skills of firms in the program. Program managers do not know, for example, whether firms nearing the end of their 8(a) program terms have sufficient experience in contracting or contracts outside of the program to provide the firms with a reasonable chance of success after they leave the program. Mr. Chairman, our position has been and continues to be that to effectively manage and assess the 8(a) program, SBA must have knowledge on firms' overall growth and the program's ability to provide the contracting opportunities, management assistance, and other services needed to develop these firms as viable small businesses. This knowledge can be obtained through the use of an effective management information system. Such a system is not yet in place at SBA.

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This concludes my prepared statement. I would be glad to respond to any questions that you or Members of the Committee may have.

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The CHAIRMAN. Could you determine whether or not SBA can do a better job of dispersing these contracts and bringing more people into the contracts, or is it, just by its nature most Federal business is here and therefore that is where all the business goes?

Ms. WILLIAMS-BRIDGERS. There are several issues at work here. One, there seem to be some competing mandates for SBA. There is a mandate that they work to promote that contracts get in the hands of many firms. But at the same time, SBA is mandated to work with procuring agencies when they recommend a particular firm for a contract. So since 95 percent of the contracts that are let are made with the recommendation that a particular firm be involved in that particular contract, SBA's hands are tied.

But you are right, Senator, that there is a geographic dispersion of firms that are in particular businesses so that there are certain business types that are located in certain areas. And that also works against SBA's efforts to try and disperse the contracts among a variety of different firms.

The CHAIRMAN. Could you tell whether or not most of these contracts are service contracts, or are they manufacturing contracts?

Ms. WILLIAMS-BRIDGERS. We have some statistics from SBA on the dispersion of business types across 8(a) firms. I believe that over time it has changed and more recently the numbers indicate that about 30-some percent of the firms are in the professional service areas.

The CHAIRMAN. Is that software, computer-type things?

Ms. WILLIAMS-BRIDGERS. Yes, exactly. About 37 percent are in professional service areas, and about 26 percent are in construction areas. Over the past 3 or 4 years we have seen the percentage decrease in the number of 8(a) firms that are in the nonprofessional service areas.

The CHAIRMAN. What percentage?

Ms. WILLIAMS-BRIDGERS. Nonprofessional, 25 percent.

The CHAIRMAN. Do you know what percentage of the contracts that is? Are you talking about 20 percent of the firms?

Ms. WILLIAMS-BRIDGERS. Of the firms.

The CHAIRMAN. I wonder how much of the business they get in dollar volume?

Ms. WILLIAMS-BRIDGERS. I do not have that information readily available.

The CHAIRMAN. You do not know that? Is that a part of the program management information system that would be helpful to you, or not? Is that the sort of information that would go into this so-called program management information system?

Ms. WILLIAMS-BRIDGERS. I do not know if that particular datapoint is now included in the setup for the management information system, but certainly it would be helpful to know where the industries' major procuring activities are occurring so that SBA can help to direct firms to those activities.

The CHAIRMAN. Why couldn't the SBA issue a regulation to all their 8(a) contractors, or send them a form at the end of each year telling them to notify SBA as to how much non-8(a) business they did in dollar volume as a percentage of their total volume this year? Why couldn't they do that? You say they cannot tell you how much non-8(a) business these 8(a) contractors have done.

Mr. RITCHICK. Mr. Chairman, they already get that information, be it in the form of financial statements or whatever, that the firms are required to submit to SBA on an annual basis, quarterly basis, semiannual basis. It may not be so much a question of not getting the information as just not reviewing it, analyzing it, having any kind of a management information system.

The CHAIRMAN. Is that another case where the Government asks for information that it does not do anything with?

Mr. RITCHICK. In a lot of cases. When we did our earlier work, we found evidence that this information was coming in, but as we pointed out in the statement today and in our earlier statements, when these annual reviews are not completed this information is just basically sent into the respective field offices and basically nothing is done with it. So it may not be a problem in a number of cases of not getting the information as is the case of not reviewing it or acting upon it once they do get the information.

Ms. WILLIAMS-BRIDGERS. The problem is also compounded by Washington not having readily available program managers and Washington not having readily available that information in a collective way so as to be able to look in a more global sense at what types of activities, what types of contracts, the 8(a) firms are engaged in so that it might know how to better redirect the overall program efforts.

The CHAIRMAN. Does the law penalize 8(a) contractors anyway? In other words, for example, they are supposed to graduate after 8 or 9 years in this program. You are not going to graduate people who have never had their first contract, are you? The law does not require that, does it? I should know the answer to that, but I do not.

Mr. RITCHICK. It is our understanding that at the end of the 9-year period that, depending on whether you get a contract or not, when your 9-year period is up it is supposed to be up.

The CHAIRMAN. You are out.

Mr. RITCHICK. And you are out.

The CHAIRMAN. If you are certified, and you have not done a contract in 8 years you are gone—9 years? That does not make much sense, does it, if it is not his fault he does not get any contracts?

Mr. RITCHICK. I think one of the situations that also has to be overcome is that the 8(a) program over a number of years has had a history of being a contracting program. I think the 1988 amendments and all that took place even before then, but primarily the 1988 amendments, tried to stress the business development aspects of the program and to drive home the point that the firm is in the program to develop itself, market itself, and so on. It could be a combination of, in some cases, firms coming into this program and lacking the ability. They are unable, or maybe they are even unwilling, to take on this kind of a self-marketing, not self-developmental, but self-marketing activity.

It could be a little bit of both, them being unable to or just maybe expecting something from the SBA or from the procuring agencies in the way of contracts that the program is trying to get away from, from being a contract giveaway program to becoming a business development program.

The CHAIRMAN. Senator Pressler.

STATEMENT OF HON. LARRY PRESSLER, U.S. SENATOR FROM SOUTH DAKOTA

Senator PRESSLER. Thank you, Mr. Chairman. I wish to make my opening statement in the record and I just have a couple of questions.

[The prepared statement of Senator Pressler follows:]

STATEMENT OF SENATOR LARRY PRESSLER

I would like to thank the Chairman for calling this important hearing on P.L. 100–656, the "Business Opportunity and Development Reform Act of 1988." I also would like to tank each of today's witnesses for appearing to testify about this law to improve the Small Business Administration's Minority Small Business and Capital Ownership Development (MSB/COD) Program. I would especially like to welcome Derek Vander Schaaf. Mr. Vander Schaaf and I hold more in common than an interest in the subject of today's hearing. We also happen to share the same alma mater—the University of South Dakota. At the risk of sounding proud, you would be hard pressed to find a university program that better prepares a person for the kind of work Derek is called upon to do. It isn't often you find two USD alumnae participating in a Senate hearing together and I again welcome Derek here this morning.

Although my home state of South Dakota only has fifteen small businesses certified in this SBA initiative commonly referred to as the "8(a) program," I know they all are concerned that the program function efficiently and effectively. The reforms passed in 1988 were designed to do just that. Unfortunately, in practice the results have been less than we had hoped for.

Two of my constituents recently painted a contrasting picture of the 8(a) program. One described a maze of bureaucratic paperwork connected with the 8(a) certification process. He summed up his feelings by saying he feels the SBA is "nearly a worthless organization" to him. The other, however, gave the SBA accolades for the 8(a) program and credited the SBA with making the 8(a) program more accessible to businesses based on Indian reservations.

It is no secret the 8(a) program has had its share of problems. I believe the testimony of today's witnesses, the fact we are holding this hearing, and the anticipated legislation from Senator Kerry designed to overhaul 8(a), stand as testaments to the program's beleaguered state. Hundreds of pages of studies and testimony already have documented flaws within this program. In a report issued in September 1993, the Government Accounting Office (GAO) confirmed that, "over the years . . . SBA has continually had problems in administering the 8(a) program." And at a hearing conducted by our colleagues in the House on September 22, 1993, SBA Administrator Erskine Bowles bluntly labeled the chronically malfunctioning 8(a) program, "a mess."

Clearly, Congress and the SBA must continue to work to level the playing field for small disadvantaged businesses. To achieve this goal, the current program must be fixed. I look forward to working on solutions that may be presented to this committee. I also look forward to hearing from today's witnesses. Their testimony will prove valuable as we work to improve the future of the 8(a) program and the businesses for which it was created.

Senator PRESSLER. Some of the areas I am interested in have already been covered. Now, I mention in my opening statement that one South Dakota firm is particularly unhappy with the current 8(a) program. The owner, an American Indian, feels the 8(a) program does not offer adequate opportunities to Indian-owned firms. Have you encountered any evidence of inequality among different ethnic groups within the program?

Ms. WILLIAMS-BRIDGERS. Senator, we have not specifically looked at the dispersion of contracting activity across ethnic groups.

Senator PRESSLER. Your testimony states that in each year from 1990 to 1993 more than 50 percent of 8(a) participants never received an 8(a) program contract. You also state that SBA is uncertain as to what percentage of these firms receive certification without the intent of ever using it to procure Federal contracts. Do any

of the studies conducted by your Agency offer an indication as to how much this factor contributes to the high number of nonparticipating 8(a)-certified contractors?

Ms. WILLIAMS-BRIDGERS. No, we have just heard this on occasion, that many firms do not ever intend to seek Federal procurement contracts. But we do not really have a good handle on that 50 percent that never participate to understand why they do not.

Senator PRESSLER. I agree with your testimony's conclusion that more comprehensive data is needed in order to assess the effectiveness of the program. I also am disturbed that of the $1 million designated to improve the management information system only $17,500 has been spent on this effort. How was the $1 million figure for the improvement determined and what sort of salaries and benefits required the $600,000 expense that apparently was reprogrammed away from the redesign?

Ms. WILLIAMS-BRIDGERS. Your question is excellent, Senator. We, in fact, have been trying to pursue an answer to that question ourselves. We have been trying to get a good estimate from SBA as to the total cost of fully implementing the system. We have not been able to get an answer from SBA in that regard.

Senator PRESSLER. Mr. Chairman, could staff submit that question on my behalf?

The CHAIRMAN. Certainly.

Senator PRESSLER. I think that is something we should have for the record, if we could get that from SBA.

The CHAIRMAN. Part of that question ought to be, "Do you have enough money to do it? If you know what it is going to cost, do you have the money?"

Ms. WILLIAMS-BRIDGERS. We have not been able to get a total cost estimate for full implementation.

The CHAIRMAN. Did you say you do have?

Ms. WILLIAMS-BRIDGERS. We do not.

Also, the $650,000 that was reprogrammed, as we understand it, was for programs for salaries and benefits that may or may not have included employees who were assigned to implementation of the MIS system. To the best of our understanding, some of that $650,000 was used to pay for salaries and benefits for employees not associated with the MIS implementation. So it may not have directly benefitted the MIS.

Mr. RITCHICK. Senator, the $950,000 was also in discretionary funds, from our understanding. It was not money that was specifically programed for the ADP system. It was discretionary money that they intended to use and then subsequently pulled out the salaries and benefits.

Senator PRESSLER. Now, Mr. Smith's commission suggested, "that most authorities recited in section 8(a) of the Small Business Act be taken away from SBA and invested in another new agency created by statute in the Department of Commerce." Do you agree that such an action would improve the accountability and correct pervasive and repetitive mismanagement of the 8(a) program, and in your view would this move have any perceptible effect on other Agency operations?

Ms. WILLIAMS-BRIDGERS. Not knowing what particular infrastructure might exist in this new agency, it would be very difficult

for us to say whether or not an agency housed within the Department of Commerce would be the most appropriate place for the 8(a) program to be placed. However, we do feel that wherever the program is located, whoever administers the program, whichever agency houses the 8(a) program, that there are some fundamental pieces of infrastructure that have to be in place, be it the management information system. Be it capable staff that are trained to provide the types of assistance that 8(a) firms need, the appropriate level of resources committed to monitoring and tracking and helping firms develop their business plans, those tenets are essential wherever the program is located.

Senator PRESSLER. My last question is this: From each of our witnesses we have testimony providing many examples of 8(a) competition avoidance. One example not given here today appeared in a February 1994 GAO report dealing with the Department of Energy's egregious abuse of nonmanufacturing thresholds in the 8(a) program. That report showed that prior to the adoption of a $300,000 sole-source threshold for nonmanufactured procurements the DOE offered 10 procurements. After the threshold was established, no contracts were offered above the competitive award threshold. So the questions are, in those cases, who is held responsible for manipulating contracts to avoid competition, how are responsible parties punished, and are the loopholes that exist the result of congressional action and do you feel current punitive measures effectively deter future transgressions?

The CHAIRMAN. Would you repeat the question? [Laughter.]

Senator WELLSTONE. And the answers within 1 minute.

Ms. WILLIAMS-BRIDGERS. Would you mind repeating some parts of that question, Senator?

Senator PRESSLER. It is the February 1994 GAO Report. Are you familiar with that, dealing with DOE?

Ms. WILLIAMS-BRIDGERS. No, I am not, sir.

Senator PRESSLER. Well, that is what this question is based on.

Ms. WILLIAMS-BRIDGERS. I would be glad to get back to you with an answer if I may, sir.

Senator PRESSLER. OK.

Ms. WILLIAMS-BRIDGERS. Thank you.

Senator PRESSLER. Thank you, very much.

The CHAIRMAN. Senator Kerry?

Senator KERRY. Thank you, Mr. Chairman.

Ms. Williams, looking through your statment, and it is a rather succinct and damning summary of problems within with SBA more than per se with the 8(a) program. And I think it does a lot of good to tell the story of what has happened here. But I want to make sure I understand it accurately.

On the competitive award contracts, you are pointing out to the Committee that indeed that has improved, is that accurate, that there is a greater amount of competitive awards being made now than there was previously?

Ms. WILLIAMS-BRIDGERS. For the years for which we were able to obtain data.

Senator KERRY. Understood. And we have to also remember that in 1988, when we first came around on the reform effort, this was a sole-source program and there was nothing competitive, correct?

Ms. WILLIAMS-BRIDGERS. Correct.

Senator KERRY. So there has been at least that step forward. Now, I do not find a lot that is encouraging on the SBA's performance beyond that. In fact, as I look through this, you have pointed out, first of all, that the concentration of contracts that we pointed out 6 years ago, among a relatively few firms still continues, and that, we tried to address, correct?

Ms. WILLIAMS-BRIDGERS. Correct.

Senator KERRY. The SBA clearly has not taken management steps to make that happen, is that accurate?

Ms. WILLIAMS-BRIDGERS. That is correct, Senator.

Senator KERRY. In addition to that, the SBA is not conducting annual reviews of the approved business plans as they are required to do.

Ms. WILLIAMS-BRIDGERS. We found variance among the field offices in the degree to which they conduct those annual reviews, that is correct.

Senator KERRY. In addition to that, SBA could not tell you whether the plans are being annually reviewed or modified to reflect firms' development goals and so forth. So there is no linkage of the SBA management oversight to what these companies are doing.

Ms. WILLIAMS-BRIDGERS. That is correct, sir.

Senator KERRY. In addition to that, SBA could not provide you with any information about the extent to which 8(a) firms were meeting their non-8(a) business levels.

Ms. WILLIAMS-BRIDGERS. They could not do it readily, and in a collective sense they have no idea. That is correct. They have to query each individual field office to find that information.

Senator KERRY. That is one of the most fundamental goals of this program.

Ms. WILLIAMS-BRIDGERS. We agree, sir.

Senator KERRY. In addition to that, they have been attempting to develop a systematic process for collecting data, but evidently that is a disaster within the SBA and their initial efforts to design a system were not planned in accordance with Federal regulations and guidelines.

Ms. WILLIAMS-BRIDGERS. Not having the up-front planning that is required in Federal regulations, that is correct.

Senator KERRY. And in addition to that, they have implemented a system that is not capable of providing management with 8(a) program information. I read through this and it still lacks the capability to provide program managers with information on other eligibility issues.

Ms. WILLIAMS-BRIDGERS. In fact, that is one area where most recently SBA has been able to demonstrate to us that they have made some progress in their certification tracking system. That part of their information management system has been fully implemented.

Senator KERRY. But in summary, most damning of all, perhaps, is that the SBA, responsible for the implementation and oversight, charged with redressing the problems that we identified 6 years ago, is now in 1994 still not in a position to even evaluate the program's overall success in developing minority businesses.

Ms. WILLIAMS-BRIDGERS. That is our bottom line, sir. Yes.

Senator KERRY. Well, that is an extraordinarily damning bottom line. It is a candid and frank statement, and it really underscores if the management process of the oversight managers is incompetent, it is hard to see how they can teach people who are there to learn from them how to manage and grow a business. If they cannot even collect the fundamental information and do not try to, it is hard to understand how they can give decent feedback.

My bottom-line question to you, is do you believe that there is a distinction between the 8(a) program and what it seeks to do, and these management inefficiencies and the impact they have had on the program?

Ms. WILLIAMS-BRIDGERS. There is direct linkage. The goals of the 8(a) program are good objectives. They are social goals that should be achieved. However, from what we have seen from SBA's ability to provide the oversight, to provide the necessary guidance, to collect the type of information that allows it to provide the appropriate guidance, it is absent.

Senator KERRY. Has anybody been fired? Has anybody been held accountable for any of this?

Ms. WILLIAMS-BRIDGERS. I am not aware of personnel actions taken at SBA, sir.

The CHAIRMAN. We never have had anybody in charge over there long enough to get fired. [Laughter.]

Senator KERRY. I would love to know if they are still working in some other corner or rewarded. That is up to us, and we will try to learn that from some other inquiry here.

With respect to your report and the Commission on Minority Business Development Report and other participants, there is obviously tension between the burdens people feel in the reporting that they have to do in the administrative and application process versus the now-discovered element of fraud which supposedly the reporting of that information would have precluded. Is there a reason that this reporting did not show the evidence of the fraud, i.e., the sort of pass-through minority status to nonminority entities, or can we safely reduce some of the paper burden, which we want to try to do in reforming this, without losing the capacity for accountability on fraud?

Ms. WILLIAMS-BRIDGERS. One potential area where fraud may exist, is in the net worth requirements. We are familiar with anecdotal evidence which would suggest that some 8(a) firms have exceeded their net worth limitations and therefore would be not considered economically disadvantaged and would no longer be eligible for participation in the 8(a) program. The evidence that we have is just anecdotal, and we are planning to soon begin an investigation looking at that particular aspect of fraud.

I do not have any work that we have completed that specifically looks at fraud issues in 8(a) to be able to comment well.

Senator KERRY. So you are really unable at this point to say how that balance ought to be struck?

Ms. WILLIAMS-BRIDGERS. Exactly. However, there is one mechanism now in place, and that is the business plans, which do reflect the financial conditions of the firms. If SBA were to pay more at-

tention to the business plans, there is a potential for us to be able to discover if that, in fact, exists.

Senator KERRY. If, in fact, either the field office or the home office were more astute in the tracking process and in the technical assistance process, they would have a much better sense of what is really going on, is what you are saying.

Ms. WILLIAMS-BRIDGERS. They would have some better sense. Whether or not that would——

Senator KERRY. Cure it completely is another matter.

Ms. WILLIAMS-BRIDGERS. Correct.

Senator KERRY. I understand.

Thank you, Mr. Chairman.

Senator WELLSTONE. Mr. Chairman, could I ask the Senator from Montana, for 1 second of his time, if he could indulge me for 1 second. I have to leave.

The CHAIRMAN. Are you on the Banking Committee, too?

Senator WELLSTONE. No, it is another meeting. I will not ask questions, I just want to apologize to you, Ms. Williams-Bridgers, and thank you for your work, I have heard a lot of interesting commentary from the minority community, small business community, in Minnesota, and I would like to put those questions to you, interestingly enough, having to do with other agencies in terms of what their interest or lack of interest is as opposed to the SBA office, and I wonder whether I could put those questions to you and maybe pursue that?

Ms. WILLIAMS-BRIDGERS. We would welcome that.

Senator WELLSTONE. Thank you very much for being here.

Mr. Chairman, thank you, and I thank Senator Burns.

The CHAIRMAN. I was busy. Did you ask a question? [Laughter.]

Senator WELLSTONE. It was a brilliant question, and it was an even more brilliant answer.

The CHAIRMAN. I did not hear the question, but I did not hear any answer. [Laughter.]

That must be a brilliant answer. That is about as good as you can do around here.

Senator Burns.

Senator BURNS. Thank you, Mr. Chairman, and thank you, Ms. Bridgers, for coming down.

I do not have any questions. I just want to tell my friend from Massachusetts that I appreciate the work that he has been doing on this, and I think he is trying to fashion some legislation that would address some of the problems and concerns that he has, and I think those concerns are across the country, about this program because it is much maligned and you hear different stories, some are good and some are horror stories. And so I appreciate your testimony this afternoon.

I am looking forward to working with Senator Kerry and the rest of the members of the Small Business Committee as we try to perfect some legislation that will enable you to get a better handle on this program and to run it like it was intended to run.

So, Mr. Chairman, that is the only thing that I have to say. I am interested in hearing from the rest of the witnesses, with no specific questions for this one. Thank you, very much.

The CHAIRMAN. Thank you, Senator.

Senator WELLSTONE. Maybe I do have time for one or two questions before I leave.

Senator BURNS. I am sorry. You have already been preempted.

Senator WELLSTONE. See, I have served on committees with Senator Burns. I usually count on long-winded statements. He is always wrong. I have to listen to him.

Senator BURNS. See, I talk just like I fight. Win or lose, it is going to be short.

The CHAIRMAN. Go ahead, Senator Wellstone.

Senator WELLSTONE. In terms of what I am hearing from small businesses in the minority community when they talk about, within the 8(a) program, problems with other Federal agencies—I am wondering whether you have any sense of other agencies openness or lack of openness to this program and how that is working and whether we have any way of monitoring that or knowing what is really going on, or does this get back again to the kind of management structure that we are talking about within SBA?

Ms. WILLIAMS-BRIDGERS. To better understand your question, Senator, are you talking about the firms' ability to obtain procurement contracts through various agencies?

Senator WELLSTONE. Yes.

Ms. WILLIAMS-BRIDGERS. We have not looked specifically at that, so I do not have any information about firms' interaction with other agencies.

Senator WELLSTONE. I think, Mr. Chairman, that is also a fertile area for inquiry, because I am sure it is not just Minnesota, but I hear more from some of the small businesses about a whole set of problems with other agencies on procurement. It is within the same sort of general area about whether or not we are going to expand opportunity, and I think that is an area of inquiry for us.

The CHAIRMAN. Senator Hutchison?

Senator HUTCHISON. Were you finished, Mr. Wellstone? Unlike Mr. Burns, I will not go on and on and on.

Senator BURNS. What is everybody picking on me for? [Laughter.]

Senator HUTCHISON. First of all, thank you. Let me say that I realize you are in the business of finding problems but not necessarily giving advice on solutions. But nevertheless, you have looked into this, and I would like to know if you have any ideas that you would share with us for doing what I think all of us want, and that is to support the 8(a) program in a way that really does benefit the recipient of 8(a) help as well as getting us to the point that we can also have the competitive market prevail.

I like the 8(a) program, and I want it to do what we intend for it to do. Do you have any thoughts about what we ought to be doing?

Would continuation of a longer period before we stop it be a possibility, or did you have other thoughts?

Ms. WILLIAMS-BRIDGERS. I think one of the very first things that we need to do is to get a handle on what is happening with the firms that are currently participating in the program. SBA does not have a global sense of whether or not the very types of management and technical assistance that it is currently providing to 8(a)

firms is the best type of assistance, or the types of assistance that these firms need in order to obtain viable contracts with agencies.

Not until we know whether or not what we are providing right now is of any benefit can we make very good steps about how to go about improving the program.

So, first and foremost we need some information. We need feedback from firms that are in the program of what challenges they are confronting that SBA may not be aware of right now so that it can better tailor the assistance to them. We need information from graduates from the SBA program on a routine basis, something that we have not had in the past.

Mr. Bowles made an excellent first step early on in his tenure of writing letters to 8(a) firms and asking them about their experiences while they were in the program or having graduated from the program. We need that kind of information on a continuous basis to know what the client population is experiencing out there.

So, it is just getting some information first on what the experience has been to date.

Senator HUTCHISON. I heard the earlier testimony about the difficulty in making the judgment because the data is not there, and I certainly support getting the data. I just wondered if you had any thoughts from any of the experiences in trying to do data collection on ways that we could improve. If you have any additional thoughts, I would appreciate your submitting those for the record.

Ms. WILLIAMS-BRIDGERS. Sure.

Senator HUTCHISON. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Hutchison. Ms. Williams, before you leave, this information system we are talking about is fairly critical, and it is critical for a lot of reasons. But you know, it is fairly easy to monitor the 7(a) program. It is not so easy to monitor these very special programs.

I remember I was almost traumatized when I first became Chairman of this Committee to find how much money the Government was about to lose by failed SBICs, and a lot of fraud, in my opinion, was being committed.

We held a number of hearings, and tried to reform the law to make sure that we did not have a repetition of that. But when you have an Agency like the SBA which has so many specialized programs designed to help specialized groups, those are very difficult. They are difficult to administer, and they are much more difficult to monitor.

And in the SBIC program I could say to the press, who were burrowing in on Wedtech and some of the scandals we had in that program, I could always say, yes, but I can name you 10 success stories. You know, Cray, Apple Computer, and Federal Express and all of those people who pay more in income tax every year that this whole program has cost since its inception.

Now, you understand when a newspaper reporter is investigating a scandal he is not interested in that, but at least you can always say that and it is very true. So that is a good justification for continuing the program despite its problems. What you try to do is solve the problem, weed out the bad guys, and make the program work better.

In the 8(a) program, we revised that program dramatically back in 1988 because we were having all kinds of difficulties with it, but a lot of those difficulties still remain, which you have just pointed out. It is a highly specialized program.

Sometimes I get so frustrated with things like this I want to just torpedo the whole program, and then I will not be bothered with whether we have got scandals or whether their information system is in place and all that sort of thing.

But if the rationale and the justification of the program is legitimate, we ought to try to make it work and we ought to continue to try to make it work, but I just get so disillusioned with this.

Now, in SBIC, as I said I could point to all kinds of successes, notably 10 that I mentioned. In this 8(a) case this information system does not even tell us what happens to these people when they graduate. I do not know if we have any successes or not.

I know Mr. Smith, who is chairman and CEO of MAXIMA who is going to testify today is a howling success, but he has been here two or three times, I think, to testify. And I would like to see these people monitored after they get off the program to determine, do they all just fall off the cliff after that or do we have a lot of Mr. Smiths out there who could come in and tell us if it had not been for this program they never would have made it. So, the information system is extremely important to us.

What you have been able to glean is just a smattering of information that we really need to do to monitor the program and, of course, also just a smattering of what we need to do to try to help these people succeed.

And finally let me ask you this. You mentioned that over a period of 3 or 4 years, 50 percent of more of these 8(a) contractors did not get a contract. I wanted to ask you, is that the same 50 percent or are you saying in any given year 50 percent of the people don't get a contract?

Ms. WILLIAMS-BRIDGERS. In any given year.

The CHAIRMAN. So, somebody might get a contract in 1991, but they are a part of the 50 percent that did not get one in 1992. Is that what you are saying?

Ms. WILLIAMS-BRIDGERS. That is correct.

The CHAIRMAN. Okay. Well, keep the faith. We are probably going to ask you to do some more work for us, Ms. Williams, but in all fairness also Erskine Bowles has asked to come up and testify to some of this and we want him to. And I would like to make this program work, but you know, I have been Chairman of this Committee now for 8 years, and I get so tired of just constantly being up-tight about is this program working or is it not? Is there a rip-off going on here or is this really promoting the reasons for setting the program up in the first place?

You pointed out that the act requires SBA to annually review each business plan, and 88 percent of the firms have had their business plans approved. Is that right?

Ms. WILLIAMS-BRIDGERS. That is correct.

The CHAIRMAN. And that 12 percent of the firms without approved business plans were either relatively new, not receiving 8(a) contracts, or in the process of being terminated from the program. Is that a good percentage or bad?

Ms. WILLIAMS-BRIDGERS. It seems to be about the best percentage that you could hope for given that some of that remaining 12 percent of the firms may have been terminated and they have not gotten any contracts. So, it seems to be the very best that they could have gotten. We would not expect 100 percent.

The CHAIRMAN. You may not be the right person to ask this question, but is there a technical assistance program for 8(a) contractors other than just what they get through a management information system?

Mr. RITCHICK. No, Mr. Chairman. They have the 7(j) management and technical assistance program that basically offers tailored, one-on-one assistance to firms. I guess it is the primary assistance program that is used by SBA to provide both management and technical assistance to the 8(a) firms.

I think in SBA what they are proposing now—it is shared, but I think one of their proposals in their minority enterprise development proposal is to basically make it so that only 8(a) firms would be eligible for 7(j) assistance. So, they have a very elaborate program of assistance.

The CHAIRMAN. Did you monitor that in your investigation?

Mr. RITCHICK. In our September 1993 report we looked at it from the standpoint only of what kind of criteria they used to assess the effectiveness of the assistance that was provided.

At that point in time we found basically there were not any objective criteria that they could use to assess and say the assistance we provided to the firm, how effective was it in either improving the firm's condition, or its business position, or whatever. That again was one of the things that was going to be developed.

But as far as we know there has not been any kind of criteria that I know of.

The CHAIRMAN. Well, you know, as I say as up-tight as I get about some of these programs, it is peanuts compared to the stories I read every day about some big contractor stiffing the Pentagon for a $1,300 toilet seat or something else. Those are always one-day stories, though, because the Pentagon has a great big public relations group that can handle it.

Thank you very much, Ms. Williams-Bridgers.

Ms. WILLIAMS-BRIDGERS. Thank you very much.

The CHAIRMAN. Our next panel is the Honorable James Hoobler, Inspector General of the Small Business Administration, and Mr. Derek J. Vander Schaaf, Acting IG and Deputy Inspector General for the Department of Defense.

Mr. Hoobler, you are number one on the list, so please proceed.

STATEMENT OF HON. JAMES F. HOOBLER, INSPECTOR GENERAL, SMALL BUSINESS ADMINISTRATION, ACCOMPANIED BY PETER McCLINTOCK, ASSISTANT INSPECTOR GENERAL FOR AUDITING, STEVEN MARICA, ASSISTANT INSPECTOR GENERAL FOR INVESTIGATIONS, SMALL BUSINESS ADMINISTRATION

Mr. HOOBLER. Mr. Chairman, members of the committee, it is a pleasure to appear before you here today. Mr. Peter McClintock, Assistant Inspector General for Auditing, and Mr. Steven Marica,

Assistant Inspector General for Investigations are both with me this afternoon.

Before I get into the issues, I would like to share briefly our investigative experience with the 8(a) program. Our 8(a) workload has decreased by about one-third since the passage of public law 100–656. It is down from an average of 59 cases per year to that of 40 cases a year.

In my opinion, this decrease can be attributed in part to three factors—one, the reforms incorporated in the 1988 amendments, two, the fraud awareness training that is conducted by the Office of Inspector General both for SBA employees and 8(a) program participants, and three, the deterrence generated by press accounts of the Government's successful prosecution of 8(a) cases.

I would now like to turn to the major issues which I believe should be addressed by the Congress when considering changes to the 8(a) program. First, it seems to me that the 8(a) program benefits only a small number of companies. Currently there are about 5,400 active companies in the program. Of those a little over 2,900 actually have contracts.

According to a recent SBA publication, there are about 1.2 million minority owned businesses in the United States. Of these 80 percent have no employees, and the others average about 3.4 employees per firm.

The 8(a) program, while obviously beneficial to a few, only helps less than 1 percent of all minority companies at any given point in time. I believe there is a real need to expand the 8(a) program to provide more opportunities to disadvantaged companies. There is little risk involved here, other than a potential lack of resources that could occur should the demand for business development assistance out strip SBA's capability to supply such support.

Secondly, I would say there are two few 8(a) companies that receive the lion's share of 8(a) contracts. No matter how you look at the numbers, the majority of Federal contracts are awarded to a small number of 8(a) program participants, thereby limiting opportunities for Federal contracting by other 8(a) companies.

As of July 8th of this year, the largest 200 companies commanded 54 percent of the contracts in terms of dollar value. These contracts averaged about $70 million for each of the 200 companies.

In my opinion any change to the 8(a) program should address this issue of concentration. A very effective control measure would be to establish a ceiling on the dollar amount of sole source contracts that a company could receive while participating in the program.

Another approach would be for the SBA to conduct the required annual recertification reviews with a firm resolve to graduate participants when either they or their companies overcome their economic disadvantage.

The third major issue, as I see, it is the participants are allowed to stay in the program even though they exceed the criteria which classified them as economically disadvantaged.

The 8(a) program is designed to assist individuals who are both socially and economically disadvantaged. SBA measures economic disadvantage in one of three ways—the individual's net worth, the financial condition of the company, and the company's access to

credit. Based on our experience, SBA could do more to measure economic disadvantage once the participant is in the program.

In 1992, the Office of the Inspector General audited a company which had received 8(a) contracts which eventually could total $440 million at their completion. We evaluated the company based on sales and other factors and concluded that it clearly had the ability to compete in the marketplace without further 8(a) assistance.

On January 19, 1993, we recommended to SBA that they initiate graduation proceedings and the Agency, as I understand it, began the process. As of last Friday, this company had yet to graduate. Moreover, it had been awarded 18 new 8(a) contracts since we first recommended graduation.

We are now completing another audit where we have evaluated SBA's procedures for assuring that 8(a) program participants meet their continuing eligibility requirements. The financial statements of the more successful companies were analyzed because they were the ones that were receiving the large dollar contracts.

Again, we find that the participants continue to remain in the program even though they have accumulated substantial wealth or have overcome impediments to obtaining access to private financing, markets, and resources.

For example, of the 50 companies reviewed in our nonstatistical sample, we found 7 individuals who exceeded the personal net worth level, and 33 companies that exceeded their respective industry's averages for business assets, revenues, gross profit, working capital, and net worth.

35 other individuals were found to have a net worth in excess of $1 million; however, due to the current spousal, home, and business equity exclusions they will be allowed to remain in the program. In my opinion, the present exclusions from net worth calculations disguise the true economic success of many 8(a) participants.

On this issue I am in favor of using criteria such as net worth thresholds because it is more objective and much more difficult to circumvent. While I am not prepared to recommend specific net worth levels or other appropriate criteria, I find it difficult to rationalize the notion that anyone who is a millionaire can be considered economically disadvantaged.

Unfortunately, the current criteria, with exclusions considered, allows millionaires to participate in a program that is designed for the economically disadvantaged. I believe the appropriate criteria for judging economic disadvantage should be based on comparisons with the overall population, rigorous research on appropriate levels of capital necessary to sustain a successful business, and strict adherence to the mandated goals of the 8(a) program.

The fourth major issue I am afraid is loopholes that allow Agencies to circumvent the thresholds to compete 8(a) awards. One of the requirements of Public Law 100–656 was to establish dollar thresholds for competitive procurement. Any service contract over $3 million and any manufacturing contract exceeding $5 million are supposed to be competed among eligible 8(a) companies.

Since January 1, 1989, only 1.9 percent of the 8(a) contracts have been competed, but, being high dollar awards, they represent almost 9 percent of all 8(a) contract dollars.

One of the reasons there have been so few competitive awards is that there has been a major loophole that allows Agencies and 8(a) companies to circumvent the competitive thresholds. This loophole is the use of the indefinite delivery-indefinite quantity contract, otherwise known in the trade as IDIQ. I understand, however, that SBA is working on a proposed regulation to close this particular loophole.

Another existing loophole, however, permitted the splitting of a proposed $9 million EPA contract into three contracts, each with a value under $3 million.

I believe more needs to be done to increase competition. First, there have been discussions to expand the Department of Defense's small and disadvantaged business set-aside program to include all Federal Agencies. Competition is obviously beneficial and requisite to the development of companies that can compete in the economic mainstream. Therefore, I would favor the extension of the SDP program to other Federal departments and agencies.

Next, 8(a) should continue in my judgment as a sole source contracting program with defensible thresholds capping the amount of sole source awards that can be given to a company on a services or manufacturing contract, as well as a dollar ceiling on the company's participation in the program.

The rationale for limiting the 8(a) program to sole source award I think is pretty straight forward. Because the Government-wide SDB program will be available for competitive awards there will not be a need, in my judgment, for a duplicate minority business set-aside program. As for sole source thresholds, I believe they are needed to encourage competition for larger contracts.

The SBA has had the authority to regulate contract support levels and contract support levels can be used to ensure that 8(a) program participants do not become overly dependent on sole source awards. They also can be used to preclude the concentration of contracts with a small number of companies. In addition, I would fully support required competitive mix levels, which require 8(a) participants to be prepared to survive in a truly competitive market environment.

The last major issue I think is excessive subcontracting, which currently allows large businesses to receive large amounts of 8(a) contract funds. SBA's current interpretation of the Walsh-Healey Act allows 8(a) companies to engage in substantial amounts of brokering with large businesses.

Audits have disclosed a number of instances in which 8(a) contractors provided significant amounts of equipment on contracts awarded under standard industrial classification codes for services. These 8(a) contractors, however, were not manufacturers nor were they regular dealers as required by Walsh-Healey. These same audits also disclosed that much of the equipment was obtained from large manufacturers, a clear violation of SBA's nonmanufacturer regulations.

Other subcontracting problems include the lack of notification to SBA or increasing subcontracting after the contract is awarded, the lack of monitoring of excessive contracting, and the difficulty really of measuring whether a company has subcontracted too much. These are important considerations that can preclude fronting or

brokering, help ensure that the 8(a) participants receive their fair share of business, and contribute to more 8(a) companies development through the experience one gains in carrying out the terms of contracts.

Again, in my opinion, there should be more control over subcontracting activities of 8(a) companies. In fact, one proposal under consideration, that is the delegation of contract administration to other Agencies, may, in my judgment, result in increased problems. Under this scenario the SBA would be removed entirely from the contract award and administration process. Consequently, the Agency will have little or no opportunity to determine whether abuse is occurring.

I have some other concerns that I would like to touch on briefly. As I said, there are some discussions underway to delegate contract award administration to procuring Agencies. I believe that some Agencies view the 8(a) program as the golden loophole to get what they want when they want it.

While I do not believe that delegation of contract administration to the procuring Agency is the most effective way to control the program, SBA, absent a healthy injection of resources, would not in my judgment be in a position to manage an expanded program. Therefore, I am forced to conclude that delegation to the Agencies may be the only option open for SBA.

The Agency will, however, require accurate and timely information on every contract action, otherwise it will become difficult to monitor eligibility, brokering, or any other potential abuse. It is also important that, once the authority is delegated to the procuring Agencies, the concomitant of accountability to the procuring Agencies must become reality. If an Agency is found to be a major abuser, there must be some remedy: for example, having SBA rescind its delegation of authority to the abusing Agency.

I also understand there are some proposals which would allow 8(a) companies to increase their investment, and I believe the range is from 10 to 20 percent, that is their investment in participating 8(a) companies subject to the approval of the SBA administrator. This type of arrangement could obviously lead to abuse if not monitored very, very carefully.

Another proposal under consideration would introduce a mentor-protege program where former 8(a) companies would mentor current 8(a) participants and in exchange be able to obtain subcontracts from these same participants. It is therefore not inconceivable that many of the mentors would be those same companies which received the lion's share of 8(a) contracts when they were participants in the program.

This situation would in turn compound the problem of concentration by allowing the flow of 8(a) contract dollars to many of these same companies. While I understand the benefit of a mentor-protegee program, I have to wonder whether it may result in a conflict of interest with the mentor's company that is given subcontracts that otherwise it just would not have access to.

Lastly, the committee requested my views on current procedures used by SBA to fulfill its Government-wide authority to review protests of self-certification by the so-called SDB companies. These are

self-certifications regarding their status as small businesses that are owned and controlled by disadvantaged individuals.

The current process is based on existing regulations and procedures that have been in place for years and have proven to be both sound and fair. The DOD's SDB program relies on self-certification, and the SBA protest system appears to be the only control available to detect fraud and abuse. In short, an appellate mechanism is essential in my judgment.

Finally, as a fairness check I would argue that there must be substantial penalties imposed on those companies which are caught submitting false certifications.

Mr. Chairman, this concludes my formal remarks. My colleagues and I would be happy to entertain any questions that you may have.

[The prepared statement of Mr. Hoobler follows:]

U.S. Small Business Administration
Washington, D.C. 20416

OFFICE OF
INSPECTOR GENERAL

STATEMENT OF

JAMES F. HOOBLER, INSPECTOR GENERAL

U.S. SMALL BUSINESS ADMINISTRATION

Before The

U.S. SENATE COMMITTEE ON SMALL BUSINESS

July 27, 1994

Mr. Chairman and Members of the Committee, it is a pleasure to testify before you today. I am James F. Hoobler, Inspector General of the Small Business Administration. Mr. Peter L. McClintock, Assistant Inspector General for Auditing, and Mr. Stephen N. Marica, Assistant Inspector General for Investigations, are with me this afternoon.

You have asked me to testify on audits and investigations undertaken by my office concerning the Minority Small Business and Capital Ownership Development Program (otherwise known as the 8(a) program), especially as they relate to the implementation of program improvements sought by the "Business Development Opportunity Reform Act of 1988," also referred to as Public Law 100-656. You also requested my views on the need for changes to the Minority Small Business program and the Business Development Opportunity Act of 1994, or the Kerry Bill. I received the Kerry Bill very recently and, therefore, have not really had sufficient time to form any judgments worthy of sharing with the Committee.

I am pleased, however, to have the opportunity to speak to needed improvements to the Minority Small Business program. While the Office of Inspector General (OIG) has increased its auditing of the Minority Small Business program in the past four years, our coverage of the program reflects our lack of resources. Therefore, our detailed knowledge of the 8(a)

program's operations is not as extensive as we would like it to be. There are certain aspects and operations of the program that we have never audited, so our experience is constrained in that respect. We are, however, familiar with P.L. 100-656 and the overall thrust of the program. We also have a fairly good base of knowledge of past and present 8(a) program fraud and abuse derived from the criminal investigation side of the OIG. My testimony is thus based on the collective knowledge of the office, as derived from both our audit and investigative activities. I will also draw heavily on certain statistics obtained from the Agency's 8(a) information system. Given these caveats, I will discuss what I believe to be some of the major current issues with the Minority Small Business program and, if applicable, the remedies that I believe are necessary to address these same issues.

Before I begin, I would also like to make two unrelated points. First, I believe there is a need to change the 8(a) program. When evaluating various issues, I used four basic criteria: (1) the program should be fair to all small socially and economically disadvantaged businesses, i.e., it should not benefit those who have overcome their economic disadvantage, big businesses, or those few companies that have mastered the esoteric details of 8(a) procurement; (2) the program should be fair to the taxpayers, i.e., it should provide Federal Government procurements at reasonable prices; (3) the program should produce viable minority-owned and controlled businesses which, upon

completion of the program, can compete successfully without further Federal assistance; and (4) the program should be easy to understand and administer due to SBA's limited resources.

Second, from an investigative perspective, I would like the Committee to understand that our 8(a) investigative workload has decreased by about one-third (from an average of 59 cases a year to 40 cases a year) since the passage of Public Law 100-656. In my opinion, the major reasons for this decrease can be attributed in part to three factors: (1) the reforms incorporated in the 1988 amendments, (2) the fraud awareness training conducted by the OIG for both SBA employees and program participants, and (3) the deterrence generated by press accounts of the Government's successful prosecution of 8(a) cases.

I will now discuss the major issues which I believe should be addressed when considering changes to the 8(a) program:

* The 8(a) program appears to benefit only a small number of companies. Currently, there are about 5,400 active companies in the program. Of those, only 2,931 companies have contracts. According to an SBA publication, The State of Small Business: A Report of the President 1993, there were about 1.2 million minority-owned businesses in the United States. Of these, about 80 percent have no employees, and those with employees average 3.4 employees per firm. The 8(a) program, while beneficial to a few, only helps less than 1 percent of all minority companies at any given point in time.

I believe there is a need to expand the 8(a) program to provide opportunities to more disadvantaged companies. The 8(a) program, as it is currently structured, assists mainly those companies which supply goods and services to the Federal Government. The addition of new phases to provide training and developmental opportunities would benefit more small, disadvantaged businesses (SDBs). I view an expansion of opportunity as a positive step toward developing minority businesses. There is little risk involved, other than a potential lack of resources which could occur should the demand for business development assistance outstrip SBA's limited resources.

* Too few 8(a) companies receive the lion's share of 8(a) contracts. No matter how you look at the numbers, the majority of Federal contracts are awarded to a small number of 8(a) companies, thereby limiting opportunity for Federal contracting by other 8(a) companies. Based on a computer run of 8(a) companies with active contracts as of July 8, 1994, the largest 200 companies commanded 54 percent of the contracts in terms of dollar value. These contracts total over $14 billion, or an average of $70 million in active contracts for each of the top 200 companies. It should be noted that these figures only include active contracts; these companies may have had other contracts that have been closed out, or they may hold options for future contracts that have yet to be exercised.

I believe the GAO has also found that concentration of many contracts among a few companies has occurred throughout the program. In its September 1993 report, GAO reviewers state that in FY92, the top 50 companies received 31 percent of the contracts (including modifications).

Concentration of 8(a) sales has been prevalent in the past three years. Using a computer search of the 8(a) data base, we found that: 116 companies received 50 percent of the 8(a) FY91 awards; 151 received 50 percent of the 8(a) FY92 awards; and 175 received 50 percent of the FY93 awards. While the trend is in the right direction, the concentration of awards to a small number of companies remains an issue.

In my opinion, any change to the 8(a) program should address the issue of concentration. I further believe there are measures that could reduce concentration. For example, a very effective control measure would be to establish a ceiling on the dollar amount of sole source contracts that a company could receive. Another approach would be for the SBA to conduct the required annual recertification reviews with an objective of graduating participants, when either they or their companies overcome their economic disadvantage.

* Participants are allowed to stay in the program even though they exceed the criteria which classified them as economically disadvantaged. The 8(a) program is designed to assist individuals who are both socially and economically disadvantaged. For purposes of the 8(a) program, economically

disadvantaged individuals are socially disadvantaged individuals whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities, as compared to others in the same or similar line of business who are not socially disadvantaged. These diminished opportunities must have precluded, or have likely precluded, opportunities for successful competition in the open market.

SBA measures economic disadvantage in one of three ways: the individual's net worth, the financial condition of the individual's company, and its access to credit. As provided in P.L. 100-656, individuals who exceed certain net worth thresholds are not considered economically disadvantaged. For entry into the program, personal adjusted net worth cannot exceed $250,000; during the developmental stage (the first 4 years of participation), it cannot exceed $500,000; and during the transition stage (the last 5 years), it cannot exceed $750,000. These limits exclude a spouse's one half interest in all community property, the individual's equity in his or her house, and any equity he or she may have in the business.

The SBA analysis of a business' financial condition is supposed to be based on a comparison of the 8(a) company with other concerns in the same or similar lines of business. SBA considers, among others, the following factors: business assets, revenues, pre-tax profit, working capital, and net worth.

When assessing access to credit and capital, SBA is supposed to consider access to long-term financing; access to working

capital financing and equipment trade credit; and access to raw materials, supplier trade credit, and bonding capability.

Based on our audit experience, SBA could do more to measure economic disadvantage once an individual and the company is in the program. In 1992, the OIG audited a Bethesda, Maryland company that had received 8(a) contracts which could total $440 million. We evaluated the company based on sales and other factors and concluded that the company displayed the ability to compete in the market place without further 8(a) assistance. On January 19, 1993, we recommended SBA initiate graduation proceedings and the Agency began the process. Admittedly, the graduation process may be long and tedious, but, as of last Friday, the Bethesda company had yet to graduate. Moreover, it had been awarded 18 new 8(a) contracts since we first recommended graduation. As things now stand, this particular company's term of program participation ends in September 1994. In short, this is an example of a company that may complete its program term of almost 10 years before it can be graduated, as its success would dictate. To the best of our knowledge, the Agency has never graduated an 8(a) company before it completed its term, based on its success in the program.

We audited another company, located in Manassas, Virginia and concluded that the owner had dramatically improved his capital and credit position, his company had grown to the point that it was larger and more profitable than other companies in the same line of business, and his personal net worth clearly

exceeded SBA's standards. Moreover, the owner had withdrawn over $6 million from his company over the last two years. Again, the OIG recommended that the SBA's District Director initiate graduation proceedings, and he agreed to do.

We are now completing another audit where we have evaluated SBA's procedures for assuring that 8(a) program participants meet their continuing eligibility requirements. The financial statements of the more successful companies were analyzed because they were receiving large dollar contracts. Again, we are finding that participants continue to remain in the program, even though they have accumulated substantial wealth or have overcome impediments to obtaining access to private financing, markets, and resources. For example, of the 50 companies in our non-statistical sample, we found 7 individuals who exceeded the personal net worth level and 33 companies that exceeded their respective industries' averages for business assets, revenues, gross profit, working capital, and net worth. Thirty-five other individuals were found to have a net worth in excess of $1 million; however, due to the current spousal, home, and business equity exclusions, they will be allowed to remain in the program. In my opinion, the present exclusions from net worth calculations disguise the true economic success of many 8(a) participants.

I believe that SBA's inability (or unwillingness) to identify those who are successful and to take appropriate action to graduate them is a contributing cause to the reason there is considerable concentration in the award of contracts. The most

successful companies obtain contracts amounting to hundreds of millions of dollars; consequently, they accumulate substantial wealth and overcome their economic disadvantage many times over. Given their expanded resources, success in recruiting personnel with excellent technical knowledge, ability to acquire expert 8(a) procedural advice from attorneys and consultants who specialize in 8(a) procurement procedure, and growing experience, they are able to dominate both the sole source and competitive 8(a) markets. I cannot believe that this was the original intent of the program. Senate Report No. 100-394 relating to the Business Opportunity Development Reform Act of 1988 stated:

> The important public purpose of the 8(a) program is severely undermined when individuals who are not socially and economically disadvantaged are permitted to participate. Such participation by non-disadvantaged individuals reduces the amount of benefits available to those who are disadvantaged, diverts the energy and efforts of the SBA, and undermines support for the program.

I fully concur with the report's conclusion.

On this issue, I am in favor of using measurable criteria, such as the net worth thresholds established by SBA, because it is much more objective and more difficult to circumvent. In fact, I would like to see additional objective criteria

established to ease the review process and to limit the need for extensive accounting knowledge and financial analysis experience. While I am not prepared to recommend specific net worth levels or other appropriate criteria, I find it difficult to rationalize the notion that anyone who is a millionaire can be considered economically disadvantaged. Unfortunately, the current criteria, with exclusions considered, permits millionaires to participate in a program designed for the economically disadvantaged. I believe the appropriate criteria for judging economic disadvantage should be based on: comparisons with the overall population, rigorous research on appropriate levels of capital necessary to sustain a successful business, and strict adherence to the mandated goals of the 8(a) program.

The current process of evaluating both a person's and a company's economic success is not an easy task. There are various complexities and loopholes that the SBA and the Congress could address to make the process easier. For example, Congress could eliminate the exclusions in determining net worth. SBA could establish other definitive thresholds, e.g., the amount of annual earnings, that would make it easier to judge whether a participant had exceeded a reasonable threshold. The current analytical construct relies, however, on a self certification and requires extensive financial analysis to arrive at a net worth figure.

* Loopholes exist that allow agencies to circumvent the thresholds to compete 8(a) awards. One of the requirements of Public Law 100-656 was to establish dollar thresholds for competitive procurement. Any service contract over $3 million and any manufacturing contract exceeding $5 million are supposed to be competed among eligible 8(a) companies. Congress believed dollar thresholds would reduce the temptation to resort to bribery to obtain large dollar value contracts, as occurred in the WEDTECH case. These thresholds would also help prepare 8(a) participants for the market competition that they will face upon graduation from the program.

Since January 1, 1989, the 8(a) information system reports that there have been 479 competitive 8(a) awards resulting in contracts totalling about $1.5 billion. In contrast, there have been over 25,000 sole source awards resulting in contracts totalling over $16.6 billion. In other words, only 1.9 percent of the 8(a) contracts have been competed, but, being high dollar awards, they represent almost 9 percent of all 8(a) contract dollars. One reason there have been so few competitive awards is that there is a major loophole that allows agencies and 8(a) companies to circumvent the competitive thresholds. This loophole is the use of the indefinite delivery/indefinite quantity contract, otherwise known as an ID/IQ contract.

Under an ID/IQ contract, a Government department or agency can order a minimum amount of goods or services with the option of ordering more, up to the maximum amount specified in the ID/IQ

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contract. The 8(a) regulations provided that the determination whether or not to compete an award would be based on the guaranteed minimum value of a contract, because that would be the amount that a company would be assured of receiving. Much of our knowledge about the ID/IQ loophole emanated from audit work by the Department of Defense's OIG. I believe my colleague, Mr. Vander Schaaf, will be addressing this matter in his remarks. I understand that SBA has submitted a proposed regulation to OMB last week to change the competitive threshold for ID/IQ type contracts to one based on the total procurement requirement, thereby closing the current loophole.

Another loophole permitted splitting of one proposed $9 million contract into three contracts, each with a value under the $3 million threshold. In 1991, a Federal agency (EPA) requested that its contract be competed; however, SBA countered with a decision to split the requirement into three sole source contracts and to award each of them to the same company. While this incident occurred in 1991, we recently asked the 8(a) program office if they had introduced any procedures to preclude such contract splitting. The responsible program manager advised that they had not, but he would move to establish such a procedure as soon as possible.

I believe more needs to be done to increase competition. First, there have been discussions to expand the Department of Defense's SDB program to include all Federal agencies. I truly believe competition is beneficial and necessary to the

development of companies that can compete in the economic mainstream; therefore, I favor an SDB concept.

Next, the 8(a) program should continue as a sole source contracting program with thresholds to cap the amount of these awards. The rationale for limiting the 8(a) program to sole source awards is straight forward -- because the Government-wide SDB program will be available for competitive awards, there will not be a need for a duplicate minority business set-aside program. Regarding the sole source thresholds, I believe they are needed to encourage competition for larger contracts. The threshold levels should be grounded in some empirical research.

The SBA also has the ability to regulate contract support levels associated with the number and value of contracts a given company can receive. Contract support levels are forecasts of future business that a firm can reasonably fulfill; such levels are currently approved at the SBA district director level. A company is not supposed to exceed its annual support level by more than 25 percent; therefore, the support level serves as a cap on the dollar value of 8(a) contracting a company can perform. I believe contract support levels can be a proficient way to ensure that 8(a) program participants do not become overly dependent on sole source awards. They would also preclude concentration of contracts with a small number of companies. Moreover, I fully support <u>required</u> competitive mix levels because 8(a) participants need to learn how to survive in a truly competitive business environment. It is true that SBA currently

imposes competitive mix targets; however, they are not always enforced. I would, therefore, support a firm competitive mix requirement.

* Excessive subcontracting allows large businesses to receive large amounts of 8(a) contract funds. SBA's current interpretation of the Walsh-Healey Act allows 8(a) companies to engage in substantial amounts of brokering and packaging in their relationships with large businesses. Audits performed by the OIG and other Federal agencies have disclosed a number of instances in which 8(a) contractors provided significant amounts of equipment on contracts awarded under Standard Industrial Classification codes for services. These 8(a) contractors, however, were not manufacturers or regular dealers as required by Walsh-Healey.

These same audits also disclosed that much of the equipment was obtained from large manufacturers, a violation of SBA's non-manufacturer regulations. These regulations require the supply of a small business product when fulfilling a small business set-aside contract. This improper subcontracting occurs because SBA does not apply the Walsh-Healey or non-manufacturer requirements to contracts which are classified as services type contracts.

Other subcontracting problems noted include the lack of notification to SBA for increasing subcontracting after the contract is awarded, the lack of monitoring of excessive subcontracting, and the difficulty in measuring whether a company

has subcontracted too much. These are important considerations that preclude fronting or brokering, help ensure that 8(a) participants receive their fair share of business, and contribute to 8(a) companies' development through their experience in carrying out a contract.

In my opinion, there needs to be enhanced control over the subcontracting activities of 8(a) companies. This will require careful consideration of the concept to delegate 8(a) contract administration to other agencies. In my judgement, such delegation may result in increased problems. Unfortunately, much of the abuse in subcontracting occurs with the full knowledge of the procuring agency. Under current procedures, the SBA has some opportunity to monitor subcontracting because all subcontracting arrangements have to be approved by the Agency. If contract administration is delegated, SBA would be removed entirely from the contract award and administration process; consequently, SBA will have little opportunity to determine whether abuse is occurring.

* Other concerns. I have a few other concerns about proposals under consideration which I will share with you. As I just mentioned, there is some consideration to delegate contract award and administration to the procuring agencies. Based on my experience, many of the abuses of the 8(a) program happen with the full knowledge of the procuring agency. This situation may be due to ignorance of the 8(a) regulations attributable to the

lack of SBA training on its program's requirements, it may be due to legitimate mistakes, or it may be intentional. Some agencies view the 8(a) program as the golden loophole to get what they want, when they want it. While I do not believe that delegation of contract administration to the procuring agencies is the most effective way to control this program, SBA, unfortunately, has not been able to manage it very well even when it has had procedures in place and enjoyed the full authority to do so. In all fairness, however, SBA does not have sufficient staff and supporting resources to administer the current 8(a) program. Absent a healthy injection of resources, which does not seem likely in these times of fiscal constraint and restructuring of the Federal work force, it would not, in my judgment, be possible for the Agency to manage the proposed expanded program. Therefore, I am forced to conclude that delegation to the agencies may be the only option for SBA. I would like to emphasize that SBA will still need to know what is going on. The Agency needs to obtain accurate information on every contract action; otherwise, it will become difficult to monitor eligibility, brokering, fronting, over-concentration in the use of particular companies, and other potential abuses. It is also important that once the authority is delegated to the procuring agencies, accountability too must be enforced. If an agency is found to be a major abuser, there must some remedy available, e.g., having SBA exercise its authority to rescind its delegation to the abusing agency.

There is consideration to allow non-8(a) companies to increase their investment (from 10 to 20%) in participating 8(a) companies. We recently came across a case where six people associated with one 8(a) company, individually owned less than the 10% limit now imposed, but, cumulatively, they owned 40% of the stock of the company under review. Interestingly, much of the 8(a) participant's subcontracts were with another company owned by these same individuals. This type of arrangement could obviously lead to abuse if not monitored carefully.

Another concept under consideration is a mentor/protege program where graduated companies will mentor 8(a) participants and will be able to obtain subcontracts from them. It is not inconceivable that many of the mentors will be those same companies which received the lion's share of 8(a) contracts while they were in the program. This will, in essence, extend their 8(a) program participation period indefinitely, which will, in turn, compound the concentration of 8(a) contract dollars flowing to those companies. While I understand the benefit of a mentor/protege program, I wonder whether it may result in a conflict of interest when the mentoring company is financially rewarded through subcontracts that otherwise it would not have access to.

Lastly, the Committee requested my views on current procedures used by SBA to fulfill its Government-wide authority to review protests of self-certifications by companies regarding their status as small businesses, owned and controlled by

disadvantaged individuals. I believe there is definitely a need for such a protest mechanism. The current procedure is based on existing regulations and procedures that have been in place for years and has proven to be both sound and fair. The only case I am familiar with relates to the procurement of dedicated telecommunication lines by the DOD. A competitor of the small, disadvantaged business (SDB) believed the SDB had an unfair advantage because almost all of the work was being subcontracted to large businesses. While it took a while for the right question to be asked, the protest resulted in finding the SDB to be unqualified because of its subcontracting relationship with the large businesses. This ruling has so far withstood appeals to SBA's Board of Hearings and Appeals. I would think that most people would agree that the SDB was acting as a broker in this situation.

The DOD program relies on a self-certification and the SBA protest system appears to be the only control available to detect fraud and abuse. While the 8(a) program goes through a fairly extensive application process to screen out non-disadvantaged businesses, the risk of fraud or abuse would, in my judgment, increase greatly should we abandon the current protest system. An appellate mechanism is a necessity. Moreover, there must be substantial penalties imposed on those companies which are caught submitting false certifications.

Mr. Chairman, that concludes my formal remarks. My colleagues and I will be happy to respond to any questions you may have.

The CHAIRMAN. Thank you very much, Mr. Hoobler. Mr. Vander Schaaf?

STATEMENT OF DEREK J. VANDER SCHAAF, ACTING INSPECTOR GENERAL AND DEPUTY INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

Mr. VANDER SCHAAF. Thank you, Mr. Chairman. I have a lengthy statement. I do not intend to read the whole statement, but there are parts of it I do want to bring to your attention.

Obviously we support the intent of the Small Business Administration's section 8(a) program, which encourages firms that are owned and controlled by socially and economically disadvantaged individuals to participate in Government programs.

Unfortunately, we believe that the amendments that were proposed to that act, under the Business Opportunity Development Reform Act in 1988 have not taken effect, and there are still a lot of problems there as this hearing has already identified.

We see these problems in the form of loopholes, as the Inspector General for the Small Business Administration has just testified to, in the area of contract bundling, use of alternative means to direct sole source contracts to designated section 8(a) firms, in the area of contract off-loading, and by using restrictive requirement specifications.

We have also reported a number of times on section 8(a) firms being used as brokers in violation of the Walsh-Healey Act and in violation of Small Business regulations.

A summary of our reports on these matters is attached to the back of my statement, so I will not get into that.

In fiscal year 1993, DOD awarded contracts totaling about $138 billion, of which approximately $25 billion was awarded to small businesses, and approximately $6.2 billion, or 4½ percent was awarded to section 8(a) firms.

However, according to information from the Federal Procurement Data System, less than 3 percent of the section 8(a) firms received over 56 percent of the total contract dollars paid to section 8(a) firms.

The CHAIRMAN. Wait just a minute. Let me digest that. $6.2 billion from DOD went to section 8(a) firms.

Mr. VANDER SCHAAF. That is right.

The CHAIRMAN. All right. Then you said according to information from the Federal Procurement Data System less than 3 percent of the 8(a) firms received 56 percent of the total contract dollars.

Mr. VANDER SCHAAF. One is talking about dollars and one is talking about the numbers of firms. In other words, of the 5,400 and some firms in the program roughly, 3 percent of those firms received over half of the DOD dollars.

The CHAIRMAN. What year was this, 1993?

Mr. VANDER SCHAAF. This is 1993.

The CHAIRMAN. I am not sure what year. I thought she said the total program was over $4 billion, and you are saying DOD put out $6.2 billion in 1993?

Mr. VANDER SCHAAF. $6.2 may be the total small business.

The CHAIRMAN. What you are doing I think is including modifications to existing contracts.

Mr. VANDER SCHAAF. You are right. I have included direct and indirect in there.

We believe that competition among 8(a) firms is imperative so that the Government can obtain goods and services in the most economical manner while nourishing the development and growth of small firms to meet the challenges of being exposed to competitive markets. We are concerned that the section 8(a) program be preserved to provide opportunities to small and disadvantaged businesses, and not to use the section 8(a) program as a means to circumvent Federal acquisition regulations. We have been unable to identify the precise extent of competition among 8(a) companies seeking Government contracts, but we have found numerous instances where competition among section 8(a) firms was restricted or eliminated. Those lopsided statistics that GAO presented and that the Inspector General at SBA just presented to me are a strong indicator that competition is weak.

The biggest regulatory loophole that we have run into is that in effect the SBA has, through its own regulations, in a sense defeated the purpose for which the amendments of the 1988 act were added. When it allowed indefinite delivery and indefinite quantity contracts, and so long as the minimum value of the contract was under the minimum values of the law, you got a situation where you could have no competition on very sizable contracts.

I have two examples on page 4 of my statement. One deals with six Navy contracts in the ADP area, which were all awarded noncompetitively, all of which exceeded the $3 and $5 million thresholds involved. And there is another one that never got awarded where the Army was going to provide a $2.6 million contract with an understanding—full knowledge that they had a $64 million contract. In reality they were going to award that on a sole source basis without competition among 8(a) contractors. We started looking at that and they pulled that contract back before we got around to it.

On page 5 of my statement I recommend going the opposite way that other people are recommending going, and that is bringing this noncompetitive award level way down to like $100,000, which would put it in line with the simplified acquisition threshold that is in the bills that are currently, I believe, in conference between the House and Senate with respect to reforming the acquisition process.

Then, and I did not lay this out in my statement because I am not sure what the right thresholds are, Mr. Chairman, but I would look at somewhere above $100,000 you compete. Maybe in the $5 to $10 million you demand competition among 8(a) contractors. You seek it all the way up.

Then above $10,000, one starts thinking about, well, that is a big contract and maybe we have to make that available. And once we decide to set it aside to all small business contractors, and I do not know where you would go with that, maybe up to the $50,000 range. The reason that I am reluctant to describe this with any precision is because somebody has got to take a look at these factors, and it is not our job in DOD to do that, it is somebody's job at the SBA to do that and sort of see how these things tend to break out so over time we can get some real competition.

If you cannot achieve that, we have suggested that as a minimum we go to a concept of guaranteed minimum value of the contract, and that if you look at the total value of the contract and if it exceeds the thresholds, then you meet the standards that are currently in the act of $3 million and $5 million. As of June 1994, the regulatory changes—there is a regulatory change in process to do that but it has not been completed. In addition, in response to our recommendations the Director of Defense Procurement issued a memo in May 1993 to all defense agencies requesting particular attention be paid to the use of indefinite delivery-indefinite quantity contracts for section 8(a) procurements, and the indefinite delivery-indefinite quantity contracts not be used to circumvent competition.

The rest of my statement is a series of other examples of where we have found nice little techniques to avoid competition in this program, and I get into something called contract bundling where we bundle up a lot of contracts, for example $371 million worth of them into eight contracts at Hanscom Field up at the Electronic Systems Command—there were literally hundreds of separate contracts at one point open to competition. Now there were eight contracts of which two were set aside for small business firms, but they were to be competed by small business 8(a) firms.

Then I have a section dealing with directed sole source contracts where in effect we picked the contractor and then forced the thing to happen, again without competition. There are some examples in my statement dealing with that.

We talk about brokering arrangements. We have had numerous audit reports which deal with brokering arrangements, particularly with the purchase of ADP, automatic data processing type equipment, where contractors have been preselected, in a sense, used the 8(a) set-aside program, and then purchased a lot of hardware when the contractor providing the hardware was neither a dealer or manufacturer, or a regular dealer or manufacturer in that equipment that was being purchased under that process.

Then we have also seen restrictive requirement specifications being used from time to time to preclude competition in the 8(a) program.

Finally we have gotten into a problem of contract off-loading. When I use that term contract off-loading I am talking about using the Government's Economy Act, sending funds to another Government Agency that has contracts with another firm, and then somehow directing that firm to get the contract. This is done, Senator, through such organizations as the Tennessee Valley Authority, the laboratories at the Department of Energy, and so forth.

The other thing that we recommend is that competition advocates, which we have in all of our major buying commands in DOD, start taking a look at the 8(a) program. Competition buying advocates tend to avoid looking at this program because they think in terms of small business and directed set-aside procurements, and they do not realize that the law provides for competition, at least competition among the 8(a)'s, and we can do a lot more in that area in the Department as well.

That briefly summarizes my statement, and I am prepared to try to answer your questions.

[The prepared statement of Mr. Vander Schaaf follows:]

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Statement by

Derek J. Vander Schaaf

Deputy Inspector General

Department of Defense

Before the

Committee on Small Business

United States Senate

on the Use of Section 8a Contracts

Mr. Chairman and Members of the Committee:

I am pleased to appear before you today to discuss Government contracts with socially and economically disadvantaged small businesses. We support the intent of the Small Business Administration's Section 8(a) program to encourage firms owned and controlled by socially and economically disadvantaged individuals to participate in Government acquisitions. Although the Department of Defense is a leader in the utilization of small businesses, we are not convinced that current practices fully meet the intent of the Business Opportunity Development Reform Act of 1988. Since 1990, both the General Accounting Office and the Office of the Inspector General, Department of Defense (OIG, DoD), have cited concerns over the limited competition in awards of contracts to small businesses. In several audit reports, we identified examples where competition among Section 8(a) firms was avoided because of loopholes in the regulations, contract bundling, use of alternative means to direct sole-source contracts to designated companies, contract offloading, and restricted requirements specifications. We also reported that Section 8(a) firms are being used as "brokers" to pass funds through non-competitively to selected firms. Those practices violate both Small Business Administration regulations and the Walsh-Healey Act.

A summary of our reports on these matters is attached for your information. I would also urge the Committee to consider whether these same problems occur in other Federal agencies, because I doubt they are unique to Defense.

Background. The General Accounting Office reported in 1993 that a long-standing problem is the distribution of Section 8(a) contracts among relatively few firms. The Small Business Administration estimated that in FY 1992 50 firms, or less than 2 percent of the nearly 4,500 Section 8(a) firms, received 31 percent of the $3.7 billion in Section 8(a) contracts awarded during the year. Conversely, the Small Business Administration also reported that in FY 1992 over 54 percent of the 4,500 Section 8(a) firms did not receive any Section 8(a) contracts.

To provide additional perspective, it should be noted that in FY 1993 the DoD awarded contracts totaling $138 billion, of which approximately $25 billion was awarded to small businesses and approximately $6.2 billion was awarded to Section 8(a) firms. However, according to information from the Federal Procurement Data System, less than 3 percent of the Section 8(a) firms received over 56 percent of the total DoD contract dollars paid to Section 8(a) firms in FY 1993.

We believe that competition among Section 8(a) firms is imperative so that the Government is obtaining goods and services in the most economical manner while nourishing the development

and growth of small firms to meet the challenge of being exposed to competitive markets. The Section 8(a) program should be preserved to provide increased opportunities to small and disadvantaged businesses, but not used as a means to circumvent federal acquisition regulations. We have been unable to identify the precise extent of competition among Section 8(a) companies seeking Government contracts, but we have found numerous instances where competition among Section 8(a) firms was restricted or eliminated. The lopsided statistics just cited are a strong indicator that competition is weak.

Regulatory Loophole. The Business Opportunity Development Reform Act forcefully encourages competition among Section 8(a) firms when a reasonable expectation exists of at least two Section 8(a) bidders, and when the anticipated award exceeds $5 million for manufacturing firms or $3 million for other acquisitions. Below these thresholds, Section 8(a) contracts can be awarded sole-source. The Small Business Administration requires the use of the "guaranteed minimum value" of the contract to determine whether a contract meets the threshold for competition. We identified a loophole in the regulation, however, that allows agencies to avoid competing Section 8(a) contracts when using indefinite delivery/indefinite quantity contracts. Agencies can sole-source a Section 8(a) contract as long as the guaranteed minimum value or the anticipated award is below the designated threshold, even if the expected total value of the contract to be awarded is higher than the threshold.

In November 1992, we reported on six Navy contracts totaling $26.6 million that were awarded to Section 8(a) firms without competition because the guaranteed minimum value of each contract was below the threshold for competition. However, for all six contracts, the actual values of the contracts were significantly above the guaranteed minimum values. For example, a contract with a guaranteed minimum value of $258,000 had contract actions totaling more than $8.2 million. The contracting officers for each of the contracts were aware of the threshold provisions and used them as a means of avoiding competition among 8(a) firms.

As another example, the Army Information Systems Selection and Acquisition Agency issued a sole-source, indefinite delivery/indefinite quantity contract to Mela Associates, a Section 8(a) firm, for requirements including mainframe computers, printers, software, database management, and installation. The Army program office established the minimum guaranteed value below the threshold, at $2.6 million, although the best estimate of the total cost of the procurement exceeded $64 million. The program office acknowledged that it was aware of other potential Section 8(a) competitors. Subsequent to a protest lodged by another Section 8(a) firm in May 1992, the procurement was withdrawn.

We recommended that competition be required for all contract awards greater than $100,000, which will become the new

simplified contract acquisition threshold with passage of pending acquisition reform legislation. As a minimum, the regulation should be revised to establish dollar thresholds for competition based on the "estimated total lifetime value of the contract," instead of the "guaranteed minimum value of the contract." The DoD Small and Disadvantaged Business Utilization office concurred with the "estimated total lifetime value" approach that we recommended and requested the Small Business Administration to implement such a policy. As of June 1994, the regulatory change is in process, but has not been completed. In addition, in response to our recommendations, the Director of Defense Procurement issued a memo in May 1993 to all Defense agencies requesting that particular attention be paid to the use of indefinite delivery/indefinite quantity contracts for Section 8(a) procurements and that indefinite delivery/indefinite quantity contracts not be used to circumvent competition requirements.

Contract Bundling. In an effort to consolidate multiple task orders for similar requirements and to reduce the administrative burden of awarding multiple contracts, DoD activities frequently combine several related procurements into a single award. This practice, often referred to as "bundling," results in an award to one, rather than several, firms, thus reducing the potential for opportunities for other vendors, both small and large. For example, we reported that Hanscom Air Force Base, Massachusetts, awarded a series of eight 5-year contracts,

valued at $371 million, for technical engineering and management support services. The 8 contracts consolidated requirements previously acquired under hundreds of separate contracts. The 8 contracts were awarded competitively, and two were reserved for Section 8(a) firms. The procurement method greatly reduced the administrative burden and costs of awarding and managing individual acquisitions, but also eliminated opportunities for other Section 8(a) firms to participate except as subcontractors to the contract awardees.

Directed Sole-Source Contracts. Federal Acquisition Regulation part 52, "Limitations on Subcontracting," requires that small businesses, including Section 8(a) firms, perform at least 50 percent of the total labor costs incurred under a set-aside contract. In conjunction with this requirement, the Small Business Administration precludes Section 8(a) firms from acting as brokers by merely passing funds to a third party to perform the work.

In two audits, we identified examples where Section 8(a) firms simply passed through funds to other firms that performed more than 50 percent of the labor. For example, in 1989, the Defense Logistics Agency issued a sole-source indefinite delivery/indefinite quantity contract without competition to Network Solutions, Inc., a Section 8(a) firm, that had a previous contract with the program office. The program office's justification for the sole-source contract was urgency in

completing work before the closing of a Defense accounting center. Network Solutions, Inc., was tasked to provide information systems products and systems integration. The Defense Logistics Agency subsequently added a task order to the original work statement for the reconciliation of out-of-balance contracts prior to their transfer to a new location. The reconciliation work was subcontracted to Coopers and Lybrand, one of the largest public accounting firms, for $6.6 million. The task orders designated for Network Solutions, Inc., accounted for only 13 percent of the total contract costs. The Defense Logistics Agency contracting officer stated that he used the Network Solutions, Inc., indefinite delivery/indefinite quantity contract because it was easier and faster than separately competing the reconciliation requirements, which he estimated would take at least 4 months. We estimated that DoD incurred $700,000 in additional costs by obtaining the reconciliation services through Network Solutions, Inc., which functioned solely as a broker.

We also reported that, in 1992, Hanscom Air Force Base passed $30.2 million of a total of $34.3 million for support services through Sumaria, Inc., a Section 8(a) firm, to 13 subcontractors. The contract with Sumaria, Inc., was awarded competitively along with seven similar contracts. However, the other contractors had met their maximum ceilings, and because the Hanscom program offices preferred to continue the use of two of the seven contractors, the contracting officer approved using

Sumaria, Inc., to pass through funds to the other firms as subcontractors under Sumaria, Inc. As a result, Sumaria, Inc., received only 12 percent of the total $34.3 million of the funds paid on the contract.

At the request of DoD managers, we are looking into complaints from small businesses concerning the impact of the small business preference program on the procurement of long-distance telecommunications services in the telecommunications resale market. Although I cannot report our findings in any detail at this time, it is clear that the preference program has had a substantial effect in this market and caused DoD to pay unnecessary premiums for long distance telephone service.

Brokering Arrangements Related to the Walsh-Healey Act. Additional restrictions against using Section 8(a) firms as brokers for automatic data processing procurements are defined in the Walsh-Healey Act, which applies to Section 8(a) contracts over $10,000. The intent of the Act is to prohibit the use of brokers by requiring that contracts for ADP materials, supplies, or services, be with contractors that are either the manufacturer or a regular dealer of the items. In addition, the Federal Acquisition Regulation requires that contracting officers obtain contractor documentation to confirm a vendor's status as a manufacturer or dealer.

We have identified instances, however, where Section 8(a) firms that were not manufacturers or regular dealers were used to obtain ADP supplies or services from a designated source, thus violating the Walsh-Healey Act. For example, in 1990, we reported that the Navy Regional Data Automation Center, Washington, DC, issued an indefinite delivery/indefinite quantity contract with World Computer Systems, Inc., a Section 8(a) firm, to obtain IBM communication systems and services totaling $3.5 million. The requirement was not synopsized in the Commerce Business Daily, thus two competing vendors were precluded from bidding. The Navy used World Computer Systems, Inc., in the believed that the firm could procure the requirement faster than the Navy could through Government procurement channels, and because the Navy could essentially specify IBM products as their requirements. Navy also violated the Walsh-Healey Act because World Computer Systems, Inc., was not a manufacturer or regular dealer of the equipment, violated the Small Business Administration regulation precluding brokers from participating in the Section 8(a) program, and incurred $50,000 in unnecessary brokering fees.

As another example, in 1989 we performed an audit to determine whether the Naval Military Personnel Command procured computer equipment in a manner that inhibited competition and favored IBM. The Navy awarded a $13 million contract to PSI International, Inc., a Section 8(a) firm that was neither a manufacturer nor dealer in ADP equipment, to manage and operate

the data center. The Navy negotiated prices exclusively with IBM through PSI International, Inc., making PSI International, Inc., a broker. IBM suggested to the Navy that directing the procurement through a Section 8(a) sole-source contract would be faster than the Navy procurement channels. Like the previous example, these actions violated the Walsh-Healey Act and the Small Business Administration regulation on broker participation in the Section 8(a) program. For this example, before the procurement transaction was completed, the Navy terminated the procurement through the Section 8(a) firm based on complaints from competitors and resistance on the part of Navy's contracting office to approve the procurement strategy.

We also reported that DoD contracting officers did not obtain vendor certifications for 6 of 87 sampled Section 8(a) contracts, totaling $33.5 million, requiring vendor certification. In addition, another 6 vendors that certified they were not ADP manufacturers or dealers were awarded contracts totaling $16.5 million. Another 20 of the sample of 87 firms certifying that they were ADP manufacturers or dealers in fact were not.

Restrictive Requirements Specifications. To encourage as much competition as possible, agencies should not use restrictive specifications. Federal Acquisition Regulations state that agencies may restrict specifications only to the extent necessary to satisfy the agency's minimum needs. A contract that specifies

a particular make and model is considered a non-competitive, sole-source contract. We reported that 16 of the sampled 87 contracts were unnecessarily restrictive, including 5 contracts that identified specific makes and models and another 11 contracts that identified brand names. For example, specifications established by the Navy Regional Data Automation Center, Washington, DC, for communications processors identified a specific make and model manufactured only by IBM. These contracts, therefore, reduced or eliminated the opportunity for competition among Section 8(a) firms. Hopefully, new policies recently placed into effect by Secretary Perry requiring the use of generic commercial specifications and standards whenever possible will help reduce occurrences of this situation.

Use of Section 8(a) Firms in Contract Offloading. In 1993, we issued a series of reports on contract offloading through other Federal agencies. Included in these reports were examples of requirements being offloaded as a means to target specific Section 8(a) contractors without competing the requirements through DoD procurement channels. For example, the Army Missile Command, Redstone Arsenal, Alabama, offloaded $741,000 through the Department of Energy to continue receiving support services from Management Technology Associates, Inc., a Section 8(a) contractor that had been performing work under an expiring contract. In addition, the Non-Acoustic Anti-Submarine Warfare program office within the Office of the Secretary of Defense offloaded $11.4 million for program management support through

the Tennessee Valley Authority to ESG, Inc., a Section 8(a) firm. ESG, Inc. was non-competitively designated as the contractor based upon a previous arrangement between the Non-Acoustic Anti-Submarine Warfare program office, the Tennessee Valley Authority, and ESG, Inc. The firm received $453,000 in brokering fees and subcontracted 96 percent of the $11.4 million it received through the Tennessee Valley Authority to another tier of subcontractors designated non-competitively by the Non-Acoustic Anti-Submarine Warfare program office. The Senate Governmental Affairs Committee has taken a welcomed interest in the practice of contract off-loading and abuse of the Economy Act. As a result of several actions by the Committee, including passage of legislation last year, this expensive contracting loophole has been closed.

Use of Competition Advocates. The Competition in Contracting Act of 1984 established competition advocates to challenge barriers and to promote competition within agencies. We find that those officials rarely review Section 8(a) contracts because such procurements are authorized exceptions to full and open competition. We believe that there would be considerable benefit in having competition advocate identify opportunities to compete under the Business Opportunity Development Reform Act. With the proposed reductions in the DoD contracting workforce, however, we recognize that sufficient resources may not be available to perform those reviews.

Summary

Mr. Chairman, in summary, in today's environment of acquisition streamlining and regulatory reductions, we cannot afford to lose sight of the need to provide opportunities to small and disadvantaged businesses. We believe that opportunities exist to increase competition and opportunities for an increased number of Section 8(a) firms. At the same time, the Government should not lose sight of the paramount goal, which is enabling Section 8(a) firms to develop their business acumen and experience so they can "graduate" from the program. We believe this can be accomplished by eliminating loopholes that allow agencies to avoid competition among Section 8(a) firms, and by effectively monitoring compliance with Small Business Administration regulations, the Walsh-Healey Act, and other related laws.

Mr. Chairman, this concludes my prepared testimony. I will be happy to respond to any questions that you or the Committee may have at this time.

Inspector General, DoD, Audit Reports Reflecting Non-competitive Practices in the Award of Contracts to Socially and Economically Disadvantaged Small Businesses.

o Report No. 94-112, "Procurement of Support Services by the Air Force Electronics Systems Center, Hanscom Air Force Base, Massachusetts," May 27, 1994, stated that the Electronics Systems Center allowed a Section 8(a) contractor to function as a broker and to subcontract more than 88 percent of the work to other firms. This action violated FAR 52.219-14 that requires small businesses to perform at least 50 percent of the total labor costs on contracts. Management concurred with recommendations to establish procedures to comply with the FAR.

o Report No. 93-068, "Procurement of Services for the Non-Acoustic Anti-Submarine Warfare Program Through the Tennessee Valley Authority," March 18, 1993 stated that the Non-Acoustic Anti-Submarine Warfare (NAASW) program office passed funds through the Tennessee Valley Authority to ESG, Inc., a designated Section 8(a) sole-source contractor. Acting as a broker, ESG, Inc. subcontracted 96 percent of the workload. As a result of the recommendations, the Office of the Assistant Secretary of Defense (Command, Control, Communications, and Intelligence) discontinued procurements through the Tennessee Valley Authority and ESG, Inc.

o Report No. 93-051, "Contract Award Protest of a Small Business Administration 8(a) Contractor," February 4, 1993, stated that the Army Information Systems Selection and Acquisition Agency (ISSAA) did not comply with small business 8(a) contracting requirements for the Installation Transition Processing program. ISSAA did not compete the program, and was going to award a sole-source procurement to Mela Associates, Inc. despite the existence of other eligible and responsible small business contractors who could reasonably be expected to submit offers at fair market price. ISSAA avoided competition by establishing a minimum guaranteed value of $2.6 million although the most likely estimated total cost for the procurement was $64.5 million No recommendations were made in the report.

o Report No. 93-042, "Allegations of Improprieties Involving DoD Acquisition of Services through the Department of Energy," January 21, 1993, stated that the Army Missile Command, through the use of an existing interagency agreement with the Department of Energy, funnelled work to a specific Section 8(a) contractor and thus avoided full and open competition. The result was an additional cost of $92,533 for the services performed. As a result of the recommendations in the report, the Deputy Under Secretary of Defense (Environmental Security) is revising DoD Instruction

4000.19, "Interservice, Interdepartmental, and Interagency Support."

o Report No. 93-024, "The Use of Small Business Administration Section 8(a) Contractors in Automatic Data Processing Acquisitions," November 25, 1992, stated that DoD components were not competing automatic data processing acquisitions with Section 8(a) Program contractors. A loophole in application of thresholds established by the Business Opportunity Development Reform Act allows agencies to avoid competing Section 8(a) indefinite delivery/indefinite quantity contracts. Section 8(a) contractors were not being reviewed for compliance with the Walsh-Healey Act. We recommended that the Under Secretary of Defense for Acquisition initiate a change action to the Defense Federal Acquisition Regulation that requires justification for not competing a proposed procurement that exceeds the dollar thresholds under the Reform Act. As a result, the Director of Defense Procurement issued a memorandum dated May 4, 1993, that emphasized the need to ensure that the use of indefinite-delivery indefinite-quantity type contracts for Section 8(a) procurements are not used to circumvent competition requirements. We also recommended that the Director, Office of Small and Disadvantaged Business Utilization, request that the Small Business Administration revise the Code of Federal Regulations, title 13, section 124.311(a)(2), from "the guaranteed minimum value of the contract" to "the estimate total lifetime value of the contract." Management concurred with the recommendation.

o Report No. 91-080, "Procurement of Contract Reconciliation Services by the Defense Logistics Agency," May 15, 1991, stated that the Defense Logistics Agency (DLA) procured contract reconciliation services on a noncompetitive basis by inappropriately adding the requirement to an indefinite quantity, time-and-materials, letter contract with a Section 8(a) firm. Management generally concurred with recommendations for DLA to develop and maintain advanced procurement plans to avoid such situations in the future.

o Report No. 90-103, "Naval Regional Data Automation Center, Washington, D.C., Procurement of Automatic Data Processing Equipment," August 24, 1990, stated that the Naval Regional Data Automation Center violated the Walsh-Healey Act by placing a $924,336 requirement through World Computer Systems, Inc., that functioned as a broker and passed the funds to IBM. As a result, the Navy incurred additional costs of $50,429 paid as a brokerage fee. The report recommended that the Naval Data Automation Command inform its regional data centers that using brokers to obtain automatic data processing equipment violates the

Walsh-Healey Act. The Navy partially concurred with the recommendation.

o Report No. 90-019, "Naval Military Personnel Command Planned Procurement of Automated Data Processing Equipment," December 15, 1989, stated that the Naval Military Personnel Command used a Section 8(a) contractor as a broker to procure ADP equipment, which violates the Walsh-Healey Act. The Navy agreed to provide training on the appropriate use of brokers for ADP procurements.

The CHAIRMAN. Thank you very much, Mr. Vander Schaaf.

How many people at DOD are involved in 8(a) contracts, do you have any idea?

Mr. VANDER SCHAAF. I have no idea, but it depends on how you draw the line. There are not a lot of people if you look at small business advocates only, and you look at people that have that title within the buying commands. But to make the programs work you have to involve all of the procurement and contracting officers in the process, so I guess we have 50,000 procurement people in the Department, or more than that, and to some extent they all have to be involved in these programs.

The CHAIRMAN. Does DOD have to comply with any other small business set-asides other than 8(a)?

Mr. VANDER SCHAAF. I assume we have to comply with all the laws.

The CHAIRMAN. I understand, but do you know of any others? Is there a small business set-aside at DOD other than 8(a) that you know anything about?

Mr. VANDER SCHAAF. No. All I know is we provide the 10 percent differential to the 8(a) contractors.

The CHAIRMAN. Well, apparently there is another program called the 1207 program.

Mr. VANDER SCHAAF. It is this program that I was just referring to, the 10 percent differential program. I am not familiar with terms you are using there.

The CHAIRMAN. All these questions that pop into my mind really need to be asked of SBA rather than either of you gentlemen.

Have either one of you had a chance to look at the bill Senator Kerry proposes to introduce?

Mr. HOOBLER. Senator, I just received it recently and scanned it, but I am not in a position really to address its contents.

The CHAIRMAN. Hopefully we will get that bill introduced in the next couple of days and we will forward you copies of it. We may want you to come back after you have had a chance to analyze the bill and tell us whether you think it addresses the problems that you are concerned about here or not.

Mr. HOOBLER. I would be pleased to do so.

The CHAIRMAN. Mr. Hoobler, your point about letting the agencies do the procuring themselves, it seems to me like you are just spreading the misery around when you do that.

Mr. HOOBLER. The point I was trying to make, Senator, is that one of the proposals circulating around town would expand the SDB program; the program that Defense has chartered.

If you expand it to all Federal departments and agencies, it is my judgment that SBA will not be in a position to manage that expanded level of activity. So, I really have to conclude, as I said in my statement, that there does not seem to be any alternative at this time.

It does not look to me like SBA is going to get many increased resources due to the reduction in the Federal workforce; so, it is just something I would have to accept. Hopefully, we can structure a system where SBA will get sufficient information to conduct the necessary oversight of the program.

The CHAIRMAN. Mr. Hoobler, when they have a $9 million contract, we will say, from DOD and they look at it and think, you know we could help a lot of small contractors by splitting this up three ways, number one, we avoid all the paper work and trauma of awarding this competitively, and we can accommodate three contractors instead of one. How prevalent is that?

Mr. HOOBLER. I do not think we have a handle on how prevalent this situation is. We only know of one very clear example, as I mentioned, the EPA contract.

The problem, as I see it, is that it really restricts competition. We should open that $9 million contract up to many people, not split it in three's and give it probably to the same contractors that we have always given business to.

The CHAIRMAN. Well, in the illustration you gave is that what happened?

Mr. HOOBLER. That is exactly what happened.

The CHAIRMAN. They not only cut it up three ways, they give it to the same person, the same contractor. Is that correct?

Mr. HOOBLER. It was the same contractor.

The CHAIRMAN. Is that correct, Mr. McClintock?

Mr. MCCLINTOCK. Yes, it is.

Mr. HOOBLER. And I should clarify, in all defense of the EPA, that it did not propose the splitting of this contract. It was SBA's decision to split the contract.

The CHAIRMAN. So, if DOD sent a contract for $20 million and said, you know, you guys dispose of this, this is a contract we want to let under the 8(a) program, does DOD not care whether SBA splits that thing up under 10 contracts as long as they get their merchandise or service?

Mr. HOOBLER. I would defer on that.

Mr. VANDER SCHAAF. I would think we would care a whole lot. It depends on the circumstances.

The CHAIRMAN. When you send it over there do you say please do not subdivide this contract?

Mr. VANDER SCHAAF. We generally would not give them an option to subdivide it. I do not think we even say please do not subdivide this contract. If we have got something that has program integrity, it stands on its own, we want to contract it that way.

My concern is that we have a program that stands alone. The example in my statement regarding this Army program points out that they had a $64 million integral contract to award and they just said we will make it an indefinite delivery contract and we will get around having to compete it that way because we know who we want to give this contract to. That is just not right.

The CHAIRMAN. It seems to me that it might be permissible if the motives are altruistic to say, for example, let us spread the joy around. We have got some people out here that we would like to share this business with. Let us cut this thing into three or four or five pieces. That could on occasion make some sense.

To split it up simply to award competition in order to give it to the same contractor borders on fraud. That really is an egregious violation of Congressional intent.

Do you agree, Mr. Hoobler?

Mr. HOOBLER. I agree.

Mr. VANDER SCHAAF. It is particularly appropriate to split it up if you know that it will be subcontracted anyway. In other words you know it is going to happen. The difficulty that quite often happens is the subcontracting that goes on ends up with a much larger firm that is not qualified under the program. You then have a situation where you cannot go through that exercise of splitting it up because it would not work; I have an example here, I think, of Coopers and Lybrand, one of the big six accounting firms in today's world, getting a major defense contract via this program.

The CHAIRMAN. Well, gentlemen, thank you very much. I would expect we will be calling you back after we introduce this bill and get your thoughts about whether it really meaningfully addresses the problem or not.

Thank you all very much for being with us.

Our final witness today is Mr. Joshua Smith, chairman and CEO of MAXIMA Corporation, and chairman of the U.S. Commission on Minority Business Development.

Well, I am advised that Mr. Smith was coming back from Chicago specifically for this appearance, and that he is 5 minutes away. We will wait the prescribed 5 minutes.

[Recess.]

The CHAIRMAN. Welcome, Mr. Smith. We appreciate what has been an extraordinary effort on your part to get here.

Before you got here I pointed out that we did not have a monitoring system to determine what happened to people after they leave this program, and I said that while we know that you have been a success we do not know who else might have been because we do not keep up with people once they leave the program.

But in any event we are very anxious to hear from you, Mr. Smith, and thank you again.

STATEMENT OF JOSHUA I. SMITH, CHAIRMAN AND CEO OF THE MAXIMA CORP., AND CHAIRMAN, U.S. COMMISSION ON MINORITY BUSINESS DEVELOPMENT, ACCOMPANIED BY ANDRE M. CARRINGTON, VICE PRESIDENT AND CORPORATE LIAISON, THE MAXIMA CORP.

Mr. SMITH. Thank you very much, Senator Bumpers. It is a pleasure to be here. But I must caution you, my definition of success is similar to that of an airline pilot, and you are only as successful as the flight you are on.

So, I appreciate your compliment about being a success but competition changes, other things change, but we certainly have gotten quite a lift and quite a foundation through the program.

Let me summarize my testimony, Mr. Chairman, and to state right up front that it really is a pleasure to be here, and I say that very sincerely. I have been looking forward to this to not only comment on what we did which we have submitted and had the opportunity to talk to you about many times, but to comment on the proposed legislation.

With me is Andre Carrington, who also is the executive director of the commission.

The CHAIRMAN. You must vote in Chicago, Mr. Smith.

Mr. SMITH. I have not met Senator Moseley-Braun in Chicago, so I am glad to meet her here.

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Mr. CARRINGTON. Good afternoon, Mr. Chairman, Senator Moseley-Braun.

Mr. SMITH. Our written testimony addresses our feelings about this issue in quite a bit of detail, but I want to discuss with you in a more personal way where we were as a commission and where this proposed legislation is. And the bottom line is that I am extremely excited. We believe without any question that 80 percent of our recommendations are in fact incorporated into the proposed legislation.

The commission had a charge to review and conduct an assessment of Federal programs but we did not stop at that. We established a strategy in the very beginning that proved to be significant.

The strategy, number one, was that in the first year we would do the report. In the second year we would implement what seemed to be the finding. And that meant that the first year was quite an active year and quite a busy year.

By the way the commission's budget was $1.4 million over 2½ years, and I have often said we were the cheapest date in Washington for 2½ years without any question, and that is because so many volunteers participated and agencies contributed. So, we were not a high ticket item for what we were able to accomplish.

But we established a strategy. Number one, I stated that we would not have hearings in Washington, and that seemed to be a very bold statement. Things seemed to be cluttered here. Only the people who can afford to travel testify. And I felt that that was not getting the lay of the land. I felt that was not the way to learn the sentiment that existed out in the country. Secondly, we would not introduce anything new. We believe without any question that prior reports had already identified the problem. The question was did the problem get attention? Did the problem receive the kind of recognition it should receive?

So, we stated up front that we would go on the road and we did. We held 18 hearings from Boston to Miami, from Atlanta to Los Angeles. Our first hearing was in Chicago, by the way. And we also attended and responded to requests to speak. I personally addressed over a quarter of a million people in 2½ years. We went to 40 States, 100 cities, and we were able to genuinely get the sentiment of what had happened in the country.

Our strategy to essentially stay away from Washington was because we did not feel that those people who could not afford to travel were heard from. We did not feel that they were part of the input. We wanted to know what would happen locally, and I am pleased to say that strategy worked.

The major recommendations we presented were in two areas, and I would say 80 percent of what we recommended is encompassed in the proposed legislation.

The first one is major structural changes to the 8(a) programming. I hope you can appreciate some of the things that happened. I was looking over the files and some of the articles that appeared in the Washington Post, the New York Times and U.S.A. Today and a few other papers, and it got to be a battle between the commission—even the SBA made personal comments about me.

But I think the bottom line is that it was very clear to us that bureaucracy was strangling the lifeblood of these companies. It did not even matter what the intent was or what the benefits were. Companies had to go through multiple iterations to apply and that was an unknown. The process was not smooth or fluent, and in the opinion of most people, in my opinion and the commission's opinion, it lacked consistency. The certification process itself was never one that had independence.

And to top it off, the major problem we ran into was that once a company, our program participant, got a contract it literally had to go to two other parties. It had to go to the original procuring agency which had the money, which had the authority, and convince them that the company could do the work. It then had to go right back to the business development specialist at SBA and reconvince them that it could do the work and the agency was willing to do the work.

So, what was there was a tripartite agreement, and very few companies can succeed when it has to go through those kinds of reiterations because you have got two unknowns. You are not just dealing with the procuring agency that wants to have the work done and can select it, you then have to go through from step one and convince SBA.

I was just ecstatic when I saw in the proposed legislation that this was one of the changes, to delegate that authority back to the agencies.

We got some black eyes because we proposed it, but I think that is one of the roles we played is to introduce some of the bold initiatives, and to get the thought processes going.

Also, I was pleased with the simplification of the certification and application processes. The proposed legislation goes leap years in accomplishing some of the most rudimentary obstacles facing minorities in the program, and I think we can look forward to some positive results from eliminating those steps.

Something else that needed to be said was regarding access to capital. And the commission agreed with the advisory committee, of which I was a member, but we felt we needed to continue to focus on access to capital. So I am pleased with the many recommendations in the proposed legislation on that issue.

We stated it a different way because we think that from a national policy this is how we need to look at minorities in business as we relate to the contributions to the national economy, and that is developing a national investment strategy looking at minorities in business as an investment and determining how we can get a return on that investment through the success in business.

And if we can start from there, then we can eliminate the real problem facing minorities in business in the corporate world as well as in the government, local, State, and Federal.

Minorities in business are seen and perceived as another social action program, and whenever you have a social action program you cannot have a business program. What you have to have is a business success which leads to social enrichment in the community. But if you look at the business as a social program it cannot be successful because you will not do business with it in the same way that you do business with others.

So, I hope that even though there is a lot of progress on the access to capital issue, that the Small Business Committee would still continue to look at the strategy and the policy of creating a national investment strategy, because once you do that other things fall in line. But when we allow the social to prevail we tend to run short.

One thing that I was particularly proud of, and the commission is proud of, is the fact that we went on the line to attack something that had been codified in law. It is in all the rules and regulations that seem to be very acceptable, and that is the term disadvantaged business.

I have said time and time again that if you can put yourself in the position of this poor small business out there that has borrowed from friends and family, soon to be ex-friends and ex-family because things can go awry, and go to this loan officer and within the business plan this business calls itself disadvantaged. And then look at the loan officer who sees his or her progression within the bank or whatever the financial institution based on successes.

If you call yourself disadvantaged, you are disadvantaged. If you are perceived as being disadvantaged, you are disadvantaged. And I remember the comment by the Chairman of the Black Caucus who said, I just never thought about that. But that perception precludes business success.

So, we beat on that every place. I personally addressed it in every speech that I gave because I felt you can have disadvantaged people, and there are disadvantaged people, but we cannot become so abbreviated in our jargon that we short-circuit disadvantaged people, and people who are disadvantaged then have disadvantaged business because in a business perspective it does not fly.

As a matter of fact, it is a sure route to failure because you do not see them as someone you will invest in. Therefore, they are not worth your time, they are not worth your attention and, heaven forbid, they certainly do not qualify for a loan. No business grows without outside capital.

So, seeing the terminology historically underutilized businesses as opposed to disadvantaged business, and seeing the term minority enterprise development instead of the 8(a) is a tremendous step forward. And as we stated in our report, if nothing else took place we feel very proud that we at least cut a path through the forest to create what I think is a different attitude, and we have tested it by enough people. And I think a quarter of a million people is enough people.

Also there are some other areas that we feel were not addressed and I feel strongly about them. The terminology is excellent. We made a recommendation to create a new agency for the development of historically underutilized businesses.

We took a calculated risk. It is interesting that when we talked to members of Congress, and that was one of our original strategies, to make sure we interacted with the Congress on a day-to-day basis, when we mentioned the 8(a) program we got a frown. When we mentioned MBDA we got a growl.

The perception of the Minority Business Development Agency was far worse in Congress, and we found that interesting. So, when

we recommended the formation of a new agency and we put it in Congress, we recognized the chance we were taking.

What we were trying to do, Senator, was show in as a comprehensive a way as we could, what a new agency should do, and to literally have SBA look at the possibility of it not being in the program.

We believe in SBA. We believe in what SBA should do. We believe it should stay to its mission of providing access to capital and opportunities and assistance, we believe in that. But we also saw SBA, and this is where SBA would tell us this, that they were being bombarded by requirements from Congress and from others, and they literally became diluted in what we considered to be their mission.

So, if we included as complete a form what another agency would do, and put an idea if there was another agency where we could put that, we would have done it. Commerce was the most logical. We recognized it would not be accepted, but we got our point across. We got the attention, if you will, and I think that strategy worked. It was a risky one but it did work.

Finally, we recommended the reestablishment of a commission. That is not in the proposed legislation, but I feel strongly that Congress needs to have an independent look at what it has done. I think the concept of a commission is proper. We were able to ask questions without having to defend or account to an Agency. We were able to do things between the cracks, so to speak, to get genuine input from people who could not afford or who did not know the process.

I recommend that whatever you do you have some kind of independent body outside of the Agency. And this is not necessarily a criticism of SBA because I believe they have come light years from where they were, and Administrator Bowles and Deputy Administrator Pulley are very admirable. But we have got to establish something that Congress has direct access to.

So, I hope that you will include some kind of continuing independent assessment of the program so that a body like ours could in fact go directly to the source and bring that back to you.

The final recommendation is one we still feel very strongly about. We recommended that there be qualifications standards established by the Office of Personnel Management for those who advise businesses. Clearly in the hearings around the country there was a challenge to the individuals who were advising. It is not only SBA, it is within Federal Agencies. And quite frankly, sir, it is in corporations. It is also in local government as well as others.

Because of the legal fear many corporations and Agencies are putting those who have been in staff positions, personnel-human resources—and this is not against personnel-human resources, but that is not business. You cannot go from EEO or affirmative action to advise business on business policies. If you do not know business you cannot advise businesses on decisions. Time and time again we saw that problem. And you put yourself in the place of a small business person who takes that advice and acts on it. They literally go out of business with bad advice.

I believe that qualifications standards for personnel advising minority business is critical. The only question I have about the pro-

posed legislation is do you really have the staff to implement it? Can you really sit down and advise a business?

My experience with those who advise was once they came to the office the student would become the teacher. There is nothing wrong with that, but I think we need to understand what we do not have and we need to focus on the personnel because that is the key to this program working. And if that can be part of the new legislation along with the other changes, I think we have an opportunity for success.

In short, we felt good about our ability to interact. As I said, we were very frugal. It was mostly a volunteer effort. I can tell you that thanks to the SBA, who contributed staff, the Department of Transportation, HUD—I think those were the major staff, and also Commerce contributed staff—we were able to do a lot with a little.

But because so much had already been done we served as more of a rallying point than a developmental point. We did not develop anything new, but we provided the forum and we went to the local communities. I can tell you we probably had several hundred articles printed about the commission around the country. We got a few here in Washington, but things tend to be a little different when it comes to——

The CHAIRMAN. No kidding.

Mr. SMITH. I have got to be polite because I may face the bridge again, but out there in the local community it is very different.

I can tell you, Senator Moseley-Braun, that we had our first meeting in Chicago. It was the best meeting we could have had. Mayor Daly literally walked from City Hall to where we were having the commission at the Federal building. I was on every TV station, every radio, and I said hey, this is great.

I went from Chicago to Dallas, and one reporter showed up, and it went downhill from there except the way we triggered it. We were then able to activate it. It is not a common priority in the community because minority businesses are viewed as social programs, and that has got to change. But I can tell you that in Chicago that did not seem to be the case.

So I want to conclude, Senator Bumpers, by just thanking you for this opportunity to give you an overview. Our testimony is complete. I am very optimistic about what has happened, what is happening, and I hope that no matter which administration is in, no matter what the qualifications of the administrator—and it is good to see a business person as administrator of a business organization. That was a step in the right direction, rather than an elected official who did not win an election. I think that is a good way to begin progress in the future.

But we have to look at minorities in business as important to our society. We have to look at the underutilization of those in the communities where if we look at creating a job by those who are in the community we have the best social program that ever existed. And we have a program that continues because I have always said that civil rights without economic strength is a borrowed event. It can be taken away at any time because you do not own it.

And I believe that what we are doing is a step in the direction of true economic strength and true enrichment of those rights that we all deserve.

Thank you very much.
[The prepared statement of Mr. Smith follows:]

MAXIMA

JOSHUA I. SMITH
Chairman and
Chief Executive Officer

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STATEMENT BY JOSHUA I. SMITH
CHAIRMAN
U.S. COMMISSION ON MINORITY BUSINESS DEVELOPMENT
AND
CHAIRMAN AND CEO, THE MAXIMA CORPORATION
BEFORE
THE U.S. SENATE SMALL BUSINESS COMMITTEE

WEDNESDAY, JULY 27, 1994

CHAIRMAN BUMPERS, I WOULD LIKE TO BEGIN MY TESTIMONY THIS AFTERNOON BY EXPRESSING MY APPRECIATION TO YOU AND SENATOR PRESSLER FOR INVITING ME TO COMMENT ON THE FINAL REPORT OF THE U.S. COMMISSION ON MINORITY BUSINESS DEVELOPMENT BEFORE THIS AUGUST BODY. I AM PROUD TO SAY THAT DURING THE COURSE OF THE COMMISSION'S DELIBERATIONS AND ANALYSIS, WE RECEIVED INPUT FROM SEVERAL MEMBERS OF THIS COMMITTEE AND THEIR RESPECTIVE STAFF MEMBERS. IN FACT, SEVERAL MEMBERS OF THE HOUSE OF REPRESENTATIVES ALSO PROVIDED TESTIMONY TO THE COMMISSION AT SOME OF OUR HEARINGS.

THE FINAL REPORT OF THE COMMISSION CONTAINED 36 RECOMMENDATIONS TO BE CONSIDERED BY THE PRESIDENT AND CONGRESS FOR CONSIDERATION OF INCLUSION IN FUTURE LEGISLATION AND POLICY DEVELOPMENT REGARDING THE FEDERAL GOVERNMENT'S MINORITY BUSINESS DEVELOPMENT INITIATIVES. FROM THE PRELIMINARY DOCUMENTS PROVIDED TO ME TO COMMENT UPON THIS AFTERNOON WHICH WERE PROVIDED TO THE SENATE SMALL BUSINESS COMMITTEE BY THE SMALL BUSINESS ADMINISTRATION, THE GENERAL ACCOUNTING OFFICE, AND SENATOR KERRY'S OFFICE - I AM PLEASED TO SEE THAT THE RECOMMENDATIONS IN THE FINAL REPORT HAVE INDEED RECEIVED SERIOUS CONSIDERATION BY THOSE ORGANIZATIONS. THE FINDINGS AND CONCLUSIONS CONTAINED IN THE FINAL REPORT REPRESENT THE CULMINATION OF ACTIVITIES CONDUCTED OVER THE COURSE OF TWO AND ONE HALF YEARS BY A BODY CONSISTING OF REPRESENTATIVES APPOINTED BY THE PRESIDENT. THE COMMISSION'S MEMBERS INCLUDED THE SECRETARIES OF DEFENSE, COMMERCE, TRANSPORTATION, AND THE ADMINISTRATOR OF THE SBA, AS WELL AS LEADERS FROM ACADEMIA AND THE MAJORITY AND MINORITY BUSINESS COMMUNITY. THE RECOMMENDATIONS ARE SUMMARIZED IN THE ATTACHED DOCUMENT. ADDITIONALLY, I AM PLEASED TO REPORT THAT MOST OF THE COMMISSION'S MAJOR RECOMMENDATIONS WERE ADDRESSED BY THE SBA AND COMPLIMENT THE EFFORTS OF ADMINISTRATOR BOWLES AND DEPUTY

ADMINISTRATOR PULLEY-ROBINSON FOR THEIR OPEN-MINDEDNESS AND SINCERITY.

FOR THE RECORD, THE COMMISSION'S ACTIVITIES CONSISTED OF EIGHTEEN HEARINGS AND TOWN MEETINGS AND OTHER ACTIVITIES WHICH TOOK PLACE IN 42 STATES AND 100 CITIES. FROM ANCHORAGE TO MIAMI, FROM BOSTON TO LOS ANGELES, AND FROM TAHLEQUAH, OKLAHOMA TO KANSAS CITY - WE GATHERED TESTIMONY FROM MORE THAN 500 WITNESSES AND APPEARED BEFORE OVER 250,000 PEOPLE. TO OUR KNOWLEDGE, THIS BY FAR PROVED TO BE THE MOST COMPREHENSIVE EFFORT OF ITS TYPE EVER UNDERTAKEN IN SUPPORT OF MINORITY BUSINESS DEVELOPMENT. THE IMPASSIONED OUTPOURING OF FRUSTRATION, OUTRAGE, AND CONCERN COUPLED WITH A NUMBER OF SUCCESSES FROM BOTH THE PUBLIC AND PRIVATE SECTOR FORMED THE BASIS FOR MUCH OF THE COMMISSION'S DELIBERATIONS.

MOST ASSUREDLY, SOME OF THE COMMISSION'S RECOMMENDATIONS WERE CONTROVERSIAL. WE DID NOT EXPECT TO AVOID DEBATE; RATHER WE ENCOURAGED IT BECAUSE IT IS HEALTHY. OUR WORST ENEMY IS APATHY, AND THE COMMISSION MEMBERS AGREED THAT WE WOULD NOT ALLOW OUR CAUSE OR OUR MISSION TO BE DEFEATED BY A COMPLACENCY WITH THE STATUS QUO OR BY A LETHARGY FOR THE FUTURE. THE PERSISTENCE OF THE SENATE IN RECOGNIZING THE SHORTCOMINGS AND PROPOSING CORRECTIVE METHODS FOR ENHANCING ALL FEDERAL PROGRAMS DESIGNED TO INCREASE THE NUMBER OF FIRMS CONTRIBUTING TO THE NATIONAL ECONOMY IS SOMETHING TO BE CELEBRATED. THE PROPOSED CHANGES FROM SENATOR KERRY GO FAR TOWARD THIS END.

ABOVE ALL, THE MEMBERSHIP OF THE COMMISSION AND THE COMPOSITION OF THE WITNESSES PARTICIPATING IN COMMISSION ACTIVITIES WAS A NON-PARTISAN TEAM, AND THE RECOMMENDATIONS MADE BY THE COMMISSION WERE WRITTEN TO BENEFIT THE ENTIRE MINORITY BUSINESS COMMUNITY. CURRENTLY, AS THE COUNTRY'S CHIEF EXECUTIVE AS WELL AS THE DECISION

MAKERS HEADING THOSE CABINET-LEVEL AGENCIES AND SBA HAVE CHANGED, THE EFFORT TO CONTINUE THE DIALOGUE, AND TO ELEVATE THE VISIBILITY AND VIABILITY OF MINORITIES IN BUSINESS IN AMERICA ALSO CONTINUES UNABATED AS EVIDENCED BY THE DRAFT "BUSINESS DEVELOPMENT OPPORTUNITY ACT OF 1994."

THE FINAL REPORT RECOMMENDATIONS ADDRESSED SPECIFIC STRUCTURAL CHANGES TO THE MINORITY SMALL BUSINESS/CAPITAL OWNERSHIP DEVELOPMENT PROGRAM. FROM THE ONSET, THE OBSERVATION ADDRESSED BY SENATOR KERRY IN THE DRAFT LEGISLATION REGARDING THE PERCEPTION OF MINORITIES IN BUSINESS WAS A SIGNIFICANT DEPARTURE FROM THE TRADITIONAL NOMENCLATURE USED TO REFER TO SUCH BUSINESSES. SENATOR KERRY SUGGESTS THAT THE TERM 8(A) PROGRAM SUFFERS FROM ALMOST UNIVERSALLY NEGATIVE PERCEPTIONS WITHIN THE GENERAL PUBLIC. ADOPTION OF A NEW PROGRAM NAME, THE "MINORITY ENTERPRISE PROGRAM" INSTEAD OF THE "MINORITY SMALL BUSINESS/CAPITAL OWNERSHIP DEVELOPMENT PROGRAM" IMMEDIATELY REFOCUSES ATTENTION ON THE ATTEMPT OF THE PROGRAM TO SUCCESSFULLY IMPLEMENT A COORDINATED BUSINESS DEVELOPMENT PROGRAM. WE APPLAUD SENATOR KERRY. THE COMMISSION HELD FIRMLY TO THE BELIEF THAT THE PERCEPTION OF MINORITIES IN BUSINESS NEEDED TO BE MADE MORE POSITIVE, AND THAT ONE WAY TO ACCOMPLISH THIS WAS TO CHANGE THE LANGUAGE USED TO REFER TO MINORITY BUSINESSES. THE COMMISSION DEVELOPED THE TERM "HISTORICALLY UNDERUTILIZED BUSINESSES" TO REFER TO FIRMS WHICH ARE OWNED AND MANAGED BY MINORITIES IN BUSINESS, AND RECOMMENDED THE TERM AS AN ALTERNATIVE TO "SOCIALLY AND ECONOMICALLY DISADVANTAGE BUSINESS." PEOPLE MAY BE DISADVANTAGED, BUT TO REFER TO A COMPANY AS DISADVANTAGED INSTANTLY CASTS A NEGATIVE PALL ON A COMPANY FROM WHICH MOST FIRMS WILL NEVER EMERGE. IT IS WITH EXTREME PRIDE AND SATISFACTION THAT THE COMMISSION ACKNOWLEDGES THAT ITS POSITION ON THIS ISSUE IS ECHOED BY THE AUTHORS OF THE DRAFT LEGISLATION. THIS

LONE ACT, WITH THE EXCEPTION OF RECOMMENDATIONS IN THE AREA OF ACCESS TO CAPITAL MAY WELL PROVE TO BE THE NUMBER ONE CATALYST FOR THE ACHIEVEMENT OF MINORITY BUSINESS AND ENTREPRENEURIAL GOALS THROUGHOUT THE UNITED STATES.

THE COMMISSION'S RECOMMENDED STRUCTURAL CHANGES TO THE MINORITY ENTERPRISE PROGRAM, IN COMPLIANCE WITH THE COMMISSION'S MANDATE, WERE DESIGNED, NOT TO DECIMATE THE PROGRAM, BUT RATHER, TO STRENGTHEN IT. AS YOU WELL KNOW, THE PROGRAM, CREATED 25 YEARS AGO, NOW ACCOUNTS FOR WELL OVER 40 PERCENT OF ALL PROCUREMENT DOLLARS RECEIVED BY MINORITY FIRMS. IN FISCAL YEAR 1990, THIS AMOUNTED TO $3.8 BILLION. IT WOULD BE A SERIOUS INJUSTICE TO THE MINORITY BUSINESS COMMUNITY TO SUGGEST DISCONTINUATION OR ELIMINATION OF ANY FEDERAL PROGRAM RESPONSIBLE FOR PROVIDING CONTRACT OPPORTUNITIES OF THIS MAGNITUDE. WHAT THE COMMISSION PROPOSED, HOWEVER, WAS A VIABLE METHODOLOGY FOR MINIMIZING THE BUREAUCRACY WHICH CURRENTLY EXISTS IN FAR TOO MANY FEDERAL AGENCIES. THIS NEEDLESS BUREAUCRATIC ENTANGLEMENT STRANGLES THE LIFEBLOOD FROM BUSINESSES OWNED BY MINORITIES, THEREBY CREATING AN UNDERUTILIZED SEGMENT OF THE U.S. ECONOMY. HOWEVER, ONE OF THE KEY RECOMMENDATIONS IN THIS AREA SUGGESTED BY THE COMMISSION CONCERNED THE QUALIFICATIONS OF THOSE SBA AND OTHER AGENCY STAFF MEMBERS CHOSEN TO ASSIST MINORITY BUSINESS PERSONS. UNFORTUNATELY, THE SBA DID NOT ADDRESS THE NEED TO HAVE PROPERLY QUALIFIED PEOPLE IN ADVISORY POSITIONS. E.G., BUSINESS OPPORTUNITY SPECIALISTS, AND WE CONTINUE TO CHALLENGE SBA'S CONTENTION THAT ALL OF THESE INDIVIDUALS ARE QUALIFIED TO ADVISE BUSINESS.

AMONG THE MOST SIGNIFICANT OF THE RECOMMENDATIONS MADE BY THE SBA IN ITS PROPOSED THREE PHASE APPROACH TO STRENGTHENING THE MINORITY ENTERPRISE DEVELOPMENT PROGRAM ARE THE REMOVAL OF ANY REAL OR ARTIFICIAL CEILING RELATED TO THE NUMBER OF FIRMS ALLOWED

TO PARTICIPATE IN THE PROGRAM, AND THE REMOVAL OF UNNECESSARY BUREAUCRATIC ENTANGLEMENTS. WITH ONLY 4,000 PARTICIPANTS IN 1992, THE PROGRAM STILL WAS RESPONSIBLE FOR CLOSE TO $4 BILLION IN PROCUREMENT DOLLARS. THE LESSENING OF BUREAUCRATIC ENTANGLEMENT, ALONG WITH THE CHECKS AND BALANCES PROPOSED BY SBA AS RECOMMENDED IN THE FINAL REPORT TO DEVELOP A FIRM FROM START UP FIRM THROUGHOUT AND EVEN AFTER GRADUATION, WILL FACILITATE A SIGNIFICANT DECLINE IN THE NUMBER OF FAILURES AMONG 8(A) GRADUATES, AND AN INCREASE IN THE NUMBER OF MINORITY ENTREPRENEURIAL START UPS. ONE OF THE MAJOR RECOMMENDATIONS IN THE FINAL REPORT CONCERNED A MORE CENTRALIZED CERTIFICATION PROCESS FOR MINORITY BUSINESS, AND EVEN THIS ELEMENT HAS BEEN ADDRESSED BY THE SBA IN ITS RECOMMENDATIONS.

IN FURTHERANCE OF THIS END TO EXCESSIVE BUREAUCRACY, THE SBA RECOMMENDS IN ITS PROPOSAL TO THE SENATE, AND THE MEASURE IS ECHOED IN THE DRAFT SENATE LEGISLATION, AN END TO WHAT THE COMMISSION REFERRED TO IN ITS REPORT AS THE TRIPARTITE AGREEMENT. THE NEW PROGRAM SUGGESTS "ELIMINATING THE SECOND-GUESSING OF BUSINESS DECISIONS MADE BY PROGRAM PARTICIPANTS AND BY CONTRACTING ACTIONS OF THE FEDERAL AGENCIES OFFERING CONTRACTING OPPORTUNITIES TO PROGRAM ACTIVITIES (UNLESS THE PARTICIPANT REQUESTS ASSISTANCE)." REMOVING THE THIRD PARTY FROM THE PROCUREMENT PROCESS ALLOWS A MORE FREE FLOW OF DECISIONS, REDUCES PAPERWORK, AND ALLOWS PROBLEMS BETWEEN VENDOR AND AGENCY TO BE RESOLVED MORE READILY.

WE APPLAUD THE SBA'S INNOVATIVE APPROACH TO FEDERAL PROCUREMENT, AND TO SOLVING THE SHORT AND LONG TERM CREDIT PROBLEMS OF STRUGGLING BUSINESS OWNERS. THEREIN LIES THE STRENGTH OF THE SBA, AND THE FINAL REPORT SUGGESTED THAT THE SBA RETURN TO ONE OF ITS ORIGINAL MAJOR OBJECTIVES FOR WHICH IT WAS

CREATED -- THAT BEING THE PRIMARY SOURCE OF POLICY AND ASSISTANCE FOR SMALL BUSINESSES TO GAIN ACCESS TO CAPITAL. THE CURRENT SBA PROPOSAL SUPPORTS THE CLINTON ADMINISTRATION'S COMMITMENT TO ENSURING THAT MINORITY-OWNED FIRMS HAVE EQUAL ACCESS TO THE MANAGERIAL AND FINANCIAL ASSISTANCE NECESSARY FOR A BUSINESS TO GROW AND PROSPER. IN ORDER FOR MINORITY BUSINESSES TO PLAY A PIVOTAL ROLE IN THE REVITALIZATION OF THE AMERICAN ECONOMY AND IN THE CREATION AND MAINTENANCE OF JOBS, THIS COMMITMENT IS PARAMOUNT. NO BUSINESS, MINORITY, MAJORITY, SMALL OR LARGE CAN EXIST WITHOUT ADEQUATE ACCESS TO CAPITAL. HOWEVER, MINORITY BUSINESSES WHICH HISTORICALLY START OUT UNDERCAPITALIZED QUITE OFTEN FIND IT NEXT TO IMPOSSIBLE TO SECURE FINANCIAL ASSISTANCE TO GROW AND EXPAND THEIR COMPANIES. RESOLUTION OF THE DILEMMA OF ACCESS TO CAPITAL AND CREDIT FOR MINORITIES IN BUSINESS IS AT THE HEART OF RESOLVING MANY PROBLEMS IN AMERICA, ECONOMIC AND SOCIAL. THE FULL UTILIZATION OF OUR MINORITY BUSINESS COMMUNITY IS THE CATALYST FOR THIS SOLUTION. WHILE OUR WAS NOT A CHARGE TO EQUATE BUSINESS DEVELOPMENT WITH CIVIL RIGHTS, I HAVE STATED MANY TIMES BEFORE: CIVIL RIGHTS WITHOUT ECONOMIC STRENGTH IS A BORROWED EVENT; IT CAN BE TAKEN AWAY AT ANY TIME.

AS THE DEFICIT OF MINORITY ENTREPRENEURS CONTINUES TO GROW, IT PRODUCES SOCIETAL PROBLEMS WHICH CRITICALLY AND NEGATIVELY AFFECT FAMILIES AND NEIGHBORHOODS. THE AFTERMATH OF THE RIOTS IN LOS ANGELES AND OTHER PARTS OF OUR GREAT NATION IN 1992 SOUNDS THE ALARM. IN MOST URBAN AND MANY RURAL AREAS OF THE COUNTRY, SMALL AND MINORITY OWNED FIRMS ARE THE PRIME EMPLOYERS OF OTHER MINORITIES LIVING WITHIN THOSE COMMUNITIES. THEREFORE, THE LACK OF VIABLE BUSINESSES OWNED AND OPERATED BY MINORITIES IS INCREASING UNEMPLOYMENT, OVERLOADING WELFARE AND CONTRIBUTING TO MORE CRIME, THEREBY PROMISING MANY REPEATS OF THE TRAGEDY OF LOS

ANGELES.

ONE OF THE ELEMENTS BROUGHT INTO THE SPOTLIGHT BY THE COMMISSION WAS THAT WE ARE SURELY DEALING WITH A HISTORICALLY UNDERUTILIZED BUSINESSES IN AMERICA, AND IT IS A SQUANDER OF TALENT AND ENERGY THAT WE CAN ILL AFFORD. IF MINORITIES OWNED BUSINESSES AT THE SAME RATE AS NON-MINORITIES AND HAD AVERAGE GROSS RECEIPTS ON A PAR WITH ALL DOMESTIC FIRMS, MINORITY BUSINESS ESTABLISHMENTS WOULD BE CONTRIBUTING BILLIONS MORE PER YEAR TO THE TOTAL ECONOMY. THAT WOULD CREATE MORE JOBS, ENHANCE TAX REVENUES, DECREASE GOVERNMENT SUBSISTENCE PAYMENTS, AND CONTRIBUTE TO AN IMPROVED QUALITY OF LIFE AND STANDARD OF LIVING FOR ALL AMERICANS. AS AN EXAMPLE OF HOW THINGS WOULD BE IF WE WERE TO TRULY UTILIZE AMERICA'S MINORITIES, THE STATE OF MARYLAND PREPARED A "WHAT-IF" SCENARIO TO INDICATE ON A ONE STATE BASIS WHAT WOULD HAPPEN IF MARYLAND'S MINORITY-OWNED BUSINESSES WERE AS BIG AS THAT STATE'S NON-MINORITY OWNED BUSINESSES. THIS STUDY CONCLUDED THAT MARYLAND WOULD EXPERIENCE OVER $3.9 BILLION IN ADDITIONAL REVENUE AND PRODUCE 38,389 JOBS! THIS CLEARLY PROVED THAT MINORITY FIRMS WERE NOT ONLY UNDERUTILIZED, THEY ARE ALSO UNDERDEVELOPED.

WITH A GREAT DEAL OF PERSONAL SATISFACTION I CAN ASSERT THAT THE COMMISSION MET ITS OBJECTIVES. WE LISTENED TO EVERYONE WHO WISHED TO BE HEARD; WE REVIEWED PREVIOUS REPORTS AND STUDIES AND HAVE CONDUCTED EXTENSIVE INVESTIGATIONS ON OUR OWN. THE FINAL REPORT WAS ONLY A PRELUDE TO THE ULTIMATE OBJECTIVE WE ALL SHARE. IT IS THAT OBJECTIVE WE PLACED BEFORE OUR ELECTED OFFICIALS AND THE GOVERNMENT APPARATUS THEY CONTROL. WE URGED CONSIDERATION OF THE COMMISSION'S RECOMMENDATIONS NOT ONLY FOR MINORITY BUSINESSES, BUT FOR ALL SMALL BUSINESSES AND FOR AMERICA'S FUTURE.

THE FOREGOING DISCUSSION IS AN EFFORT TO ADDRESS THE RECOMMENDATIONS FROM THE COMMISSION ON MINORITY BUSINESS

DEVELOPMENT'S FINAL REPORT AS THEY RELATE TO THE PROPOSED LEGISLATION AND RECOMMENDATIONS FROM SBA BROUGHT BEFORE THE SENATE. THE MAJOR AREAS COVERED IN THE DOCUMENTS COLLECTIVELY ARE IN SYNC IN MANY REGARDS. MOST PROMISING AMONG THE OVERALL ELEMENTS OF THE SUBMISSION IS THE FACT THAT THE REFERENCE TO THE COMMISSION'S FINAL REPORT BY THE GAO, AND SBA, AND THE SUGGESTION IN DRAFT LEGISLATION THAT THE COMMISSION'S RECOMMENDATIONS BE IMPLEMENTED IS A TOTAL VALIDATION OF THE EFFORTS OF THE COMMISSION, AND TRIBUTE TO ALL OF THE PARTICIPANTS IN THE COMMISSION'S ACTIVITIES.

WITH A GREAT DEAL OF PROFESSIONAL SATISFACTION AS THE CHAIRMAN OF THE COMMISSION, I SUBMIT THIS TESTIMONY TO THE SENATE SMALL BUSINESS COMMITTEE FOR CONSIDERATION, AND AGAIN, THANK YOU FOR THE OPPORTUNITY TO ADDRESS THE COMMITTEE.

The CHAIRMAN. First of all, Mr. Smith, I want to commend you and the commission on your very comprehensive product here. I apologize to you for not having had a chance to really review it in depth so that I would be a little bit more intelligent in questioning you about it.

But the fact that you got out of Washington and held so many hearings around the country was a real tribute to your vision, because here you can get a terribly jaundiced view.

There are some things that seem to me to always remain constant that do not just afflict minority businesses, it affects all small business, and that is access to capital.

In all of your hearings around the country is that still essentially the number one problem?

Mr. SMITH. It is. It is not just access to capital. I believe that capital is provided when the belief is there is a return. So, it is not just the capital issue. It is the cost-benefit issue. There have been a lot of individuals, banks, and so forth that are touting numbers, but I have talked to enough business people that are having extreme difficulty.

And keep in mind this all took place during times when the financial institutions were not at their greatest strength. The bankers blamed the regulators, and the regulators blamed the bankers, but the people who suffered were those who did not have the resources.

It was very clear that it is a matter of what do I do to take care of myself, going back to that loan officer. It takes as much time and energy to process a $10 million application as it does a $10,000 application. So, if I am looking at my yield to the bank and the profits that I am able to generate, because banks are in business to make money and loaning money is a way to do that, then I am going to look at the higher yield entities.

Therefore, I am not going to look at small businesses, and I am certainly not going to look at minorities in business because here again that gets back to that perception. I am not used to minorities being in that role. So, if I am uneasy about small businesses, I am nervous and scared about minority businesses.

We ran into the situation where banks were no matter what they were saying, and I do not blame the banks, in fact getting tighter not easier, and I do not think that has changed.

But the good news is we ran into some solutions. I am very proud of the program the State of Maryland has, and they have gone so far as to establish an equity program. The State has a different concern for viability to businesses because if a business goes away and if it is a loan program by a Federal Agency there is no impact. Someone may or may not get their bonus or something, but there is really no impact from an economic standpoint. In a State, however, jobs go away. And more importantly minorities tend to hire minorities, so one can assume that a minority business going out of business impacts minority jobs, and that has been consistent. A State has a selfish interest.

So I believe that one of the solutions is for there not only to be more and better programs by SBA, but we have got to look at how this can be downloaded to the States and local governments so that

they have more capacity to provide an investment in their own futures.

Michigan has a good program, Wisconsin, and a lot of the States that we came across have successful programs. They have taken the bull by the horns. Maryland even has gone so far, as I said, to provide equity and a number of other States provide equity. I think that is one of the keys.

They then go to the banks and, you know, a Governor can be very effective in influencing policy of a bank. Politicians can be affected because the selfish interest is all shared. If we create jobs by those in the community everyone benefits.

So, I think if we tend to go Federal to the businesses, we are going to overlook some of the major solution items or I should say areas that can provide interim, mezzanine, and bridge financing which are necessary for businesses with all the self-assured, selfish motivations that you need to have.

When we saw that realized we were seeing something that was a little different. When we see Federal down to the Agency, there is nothing that you have to account to. And, therefore, the business suffers and no one really knows.

I think we need to have more State and more local government involvement in the local financing of programs because of what I have said. And I believe the accountability, the visibility, and successes will also be more realized.

There are a lot of successes out there. There are a lot of people doing a lot of good things. You do not hear about them. They are small. They just work. That is one of the reasons we felt good about going out into the rest of the community as opposed to who can travel to Washington.

I hope that here again, as we look at whatever policy, you have a way of looking through the various cracks to determine what is really taking place. I truly urge you to establish some independent assessment outside of Congress, because I do not go to Congress for business advice either, and outside of a Federal Agency that has to account for its actions in order to get to the real people where this is intended.

The CHAIRMAN. Mr. Smith, when I got out of law school in Chicago and went back to this small town in Arkansas where I grew up, I borrowed enough money to buy a little retail outlet that my father had once owned and we had sold after he died. And I used to go to the bank with my hat in hand and pray that I could get $5,000 if I would give him the mortgage on my wife and children and dog.

Mr. SMITH. The dog always helps, too.

The CHAIRMAN. Yes, absolutely. And my brother at the same time was climbing up the ladder and was becoming president of one of the big corporations in this country, and he always wanted to come back to Arkansas and to spend all of his vacations in Arkansas. He never took any of those fancy vacations.

And I said Carroll, I just cannot imagine, when you go to Chemical Bank or J.P. Morgan and you sit down and you are trying to negotiate a $50 or $75 million loan, what do you talk about? Is that not just mind boggling? He said, no, we talk about the same thing you do when you go to the bank. We just add more zeros. And that

gave me a little bit of comfort because all they are talking about is, is it a bankable deal and the number of zeros is about the only difference.

But having said that, and this is a slight leap. You said that we do these things and set these businesses up sometimes for social reasons and I could not agree more. The 8(a) program is a product of our social concerns about a disadvantaged group of people who had to have some help in order to make it. We recognize that.

But once you do that then that business has to be on its own. That business has to stand on its own two legs. You can do it out of a social concern and, as you say, if it succeeds you have accomplished and realized a social goal.

Now, that brings me to this question. Have any people from MAXIMA left and started their own business and been successful?

Mr. SMITH. Yes, more than I like to talk about.

The CHAIRMAN. It is always your best ones who leave, too.

Mr. SMITH. I run into them when we compete. No, I am very proud of that. And more importantly, there are a number of individuals who meet with entrepreneurs when they have problems. We are doing this all time, so it is not just people in the company but people who say, look, I have help and there is just no place to go, and in terms of someone who understands a problem.

I guess I'm appearing to be negative. I am really not. I think for the reasons that just as you had the tripartite agreement back in 1968, the attitude of the country was Agencies were not going to do business with minorities. I mean, that is just where things were and we have to face the music on that. It was not a good scene for America in terms of minorities and women, but in this case we are talking about minorities.

So, I believe having SBA there in the beginning was a good thing, but after 25 years one has to really question why that has to continue. And the problem is it is hard to change things, and that is why I admire what this new bill does.

The problem is socioeconomic programs really are not social and they are not economic, and I do not know of any successes. I do not know of anyone who knows of successes. You have to have successful business programs to have the ability to provide the yield into the social community.

That does not make one more important, but without business and, in a capitalistic society, without capital and without the ability for growth it is then hard to translate that from social. So you end up taking away from one and you end up mixing, and the problem is the perception stays.

There are so many successful minorities that have a hard time proving their ability in business. And we have got to do something about why this is important to America, not just because someone is a minority, but if we have businesses where there are no jobs and where crimes are pervasive, if we have role models, look what we do for everyone, look at the burden we take off everyone. But if we look at it as another social thing then it cannot succeed.

So, we have got to make some major headway. I think we have come a long way and I am optimistic that we can get there, but it is an attitude change which is always much more difficult.

But in the case of the minority program, when you saw the faces of the hundreds of people and thousands of people that we have seen, there is a true, genuine interest to make it, to do well, to work hard. That is not absent in the minority community. But the ability to convince those to invest is very, very difficult, and somehow we have got to change that.

The CHAIRMAN. Senator Moseley-Braun?

Senator MOSELEY-BRAUN. From the outset, Mr. Chairman, I want to thank you for holding this hearing and for giving us an opportunity to hear from the witnesses. I apologize that I missed the other panels, but I am really delighted to have a chance to visit with Mr. Smith and to listen to his testimony.

Senator MOSELEY-BRAUN. But I would like to again start by congratulating Mr. Smith on his public service, on the work of the commission, it is very valuable work, and it could not frankly be more timely than it is. So I want to start out by congratulating you on being at the center of the storm with regard to something that matters to our entire country.

I would also like to say I am really delighted that you have made the point that you have made here today, that support for minority business development is not just doing nice things for minorities, but really is something that benefits and has a value to the entire country. And rather than address it as a social program, we need to address the social benefits, and that there is a distinction between the two.

But having said that and talking about the distinctions, your testimony really points to a couple of contradictions, and resolving those contradictions I guess is what becomes our job.

I have a joke, Mr. Chairman, from Illinois.

The CHAIRMAN. I could use some new material. Go ahead.

Senator MOSELEY-BRAUN. Back in Illinois we used to call the legislature the CDLS, and the CDLS is the committee to draw the line somewhere. [Laughter.]

So, we are called on to be the CDLS and sometimes that gets more thorny than not.

You raised the point on the one hand, and again this is not in terms of the contradictions, that we have to eliminate the quagmire of too much bureaucracy. We have to free up business developments from the strangle hold of too many bureaucratic fingers in the pie. And I could not agree with you more.

If anything, the bureaucratic hoops have become a transactional cost, with regard to minority business that is so often counterproductive and so much so that it really is a problem. Any time you add that kind of transactional cost on the front end of the process you build in a problem. That is on the one hand.

On the other hand, you then said that it is important that we look at strengthening qualifications for business advisors, and we need to take a look at program changes that will frankly enhance and put the bureaucracy even more involved in who does business or who is involved with minority business development.

And I guess I would like your view on how and where do you reconcile that contradiction.

Mr. SMITH. Quite simply, what I am suggesting is that the Government get out but that it be selective in what it does and that

it have the qualified people to do it as opposed to people handling paperwork and people handling process. By no means should the Government ever get out of this.

The Federal business is a very difficult business. It is probably the most difficult of all business, understanding the Federal procurement regulations, the Federal acquisition regulations, understanding Agency policy, understanding competition, and so on and so forth. It is not an easy business to get into, and you are going to need advisors.

My concern is that you understand business; that you not just go because you are a good person and you have done well here; that you have a business background; that you work in business, and that is not atypical. If you are talking with the Food and Drug Administration, if we are talking with NIH, you have to have some background in health science. If you are talking the Security and Exchange Commission, you have to understand securities.

And it is not unusual, as a matter of fact it is more typical for Agencies to require people to have a background in the mission that it represents. All I am suggesting is that if we are talking about a business agency that we have advisors who understand business, and what we uncovered was a lack of individuals who had that.

Now, I understand there are a lot of efforts in training and so forth. I do not know where that is. I still feel that because it was not in the law it needs to be put there.

But I am suggesting that you have people qualified in the right areas to provide advice, not that you simply add to the number of advisors but be more selective in terms of where they need to work. You need that partnership. It will be very difficult. You do need to provide technical assistance. You do need the training programs. And you do need the things that are indicated in the new law. You need to get away from the unnecessary steps and procedures that existed prior to that, but you need qualified people in those areas.

Senator MOSELEY-BRAUN. Well, I could not agree with you more, but you do run into a chicken and egg situation in that many of the minorities in the corporate and business world are tracked into human resources and community outreach, as opposed to bean counting.

Mr. SMITH. And that is not a negative, as I said, against those areas. It just is not an automatic translation. It just does not simply mean that because you want to do good in business you can do good. You have to have a knowledge base. There is an empirical base that is necessary. It may not be scientific, but there are business principles that you have got to understand.

I am suggesting that we be very sensitive and come up with personnel qualifications that those are active in that are. It is very, very critical. And it is probably more critical in corporate America. We run into that problem all the time because they do not want to be caught with their rules down, so to speak, or with their policies down so they put people in there, but they are not necessarily people that help businesses.

We do not recognize the gravity of what business advice means to a business that has few resources. If you make a decision and you get an accountant who gives you bad advice, you are assured

of going out of business. These are very critical, sensitive decisions that businesses are reliant upon the right advice.

So, if we enhance the qualifications during those embryonic stages we can assure more success on the other end. That is what I am suggesting.

Senator MOSELEY-BRAUN. Again, I agree with you, and that is a thorny set of contradictions that we will have to work through even in that regard because of the tradition in the corporate community.

Mr. SMITH. Can I just say, Senator, that I believe SBA is going a long way. By some of these policies that they are implementing, by a greater emphasis on finance, and by a greater emphasis in the areas indicated I believe that you are going to have some major improvements because it is just hard to participate in those areas unless you have the background. That is what I am suggesting when it comes to business development specialists, that we be extremely sensitive and have some criteria that they must pass before they just issue that advice.

Senator MOSELEY-BRAUN. You mentioned, getting back to the bureaucracy versus strengthening the qualifications, the need for an independent assessment, the need for a commission or some kind of oversight function other than just the SBA or just the Congress; that there be some independent group to make an assessment.

In that regard I would ask the question whether you think that at the present time the kind of disclosures, both by the Agencies in the Federal Government or alternatively by the private sector, the amount of information that gets shared with regard to minority business enterprise, whether that disclosure level is adequate or if we need to do more?

Mr. SMITH. Well, I think the disclosure is good. I think that is a step in the right direction. But someone has to do some kind of analysis that is not impacted by Agency policy, that is not impacted even by Congress, just simply calls it the way it is.

Some of our bold suggestions tended to work out. They could have either backfired or not been significant. I do not know which way it would have gone but we have the freedom to do it because Congress said assess the process and develop a methodology and report back to us, and we were able to do that.

So, it is having that latitude to do that, to ask questions. We talked to the district people of SBA, and when we talked under the previous administration to the SBA people in Washington all kinds of hell broke loose. It was just a battle. But it did not exist out there in the regions because we interacted with them. And I might say the Agency overall is very helpful, but we did not have to go through somebody's boss. We did not have to offend someone. We did our job and we did it within a budget, a very low budget circumstance.

So, I say that yes, having greater declaration and having more information revealed is good, but someone has got to assess, someone has got to analyze. Someone has got to do it so that Congress has an independent view of what is happening, and I think that is critical.

And as I said, I am not introducing more money. I think it can be done within the budgets that exist very easily.

Senator MOSELEY-BRAUN. With regard again to disclosure, we already have requirements in the law for banks, not other financial institutions and that is kind of a problem actually, but the banks specifically to provide what is called HMDA data with regard to housing lending activity.

The question has been raised as to, one, whether or not other financial institutions ought to similarly disclose. But my question goes to the other question that has been raised, which is whether or not there ought to be disclosure with regard to commercial loan activities in the private sector, again with a view to having something that can be monitored, that can be analyzed.

And I would just like your view. That question has come up, and I do not mean to make a statement one way or the other on the point, but just to get your reaction or impression of those proposals.

Mr. SMITH. My reaction to anything that requires more is the basic law of physics—for every action there is a reaction, and for every requirement there is a cost. I think ideally in an ideal world that might be the case. I do not know what impact it may have in terms of cost.

The cost of doing business is more competitive. It is even more critical to small businesses because if in fact those disclosures require more staff—and I am not saying it does, but one has got to be sensitive—then that is going to impact the cost of capital, hopefully not directly.

Senator MOSELEY-BRAUN. If, for example, the HMDA data of course has to be given by the financial institutions that make loans. At one point you were talking with Senator Bumpers about the access to capital for minority businesses and all the kinds of problems, both objective and subjective that minority businesses run into.

The whole purpose of the HMDA data with regard to housing loans was to provide an informational base to determine whether or not the institutions were actually lending in the communities and doing so fairly.

Again, the question has been raised in regard to commercial loans. Do you think that might have the effect of increasing lending with minority businesses or not?

Mr. SMITH. I think that it certainly would be a step in the right direction. I think we need to know, and we suggest in our report that there be more open declaration not only by the commercial agencies but even by what is happening within the agencies themselves. But here again I think we have got to make sure that as we get more data that we have the ability to analyze, because bad data, lost data, data that is not relevant to a given purpose gets to be a cost and does not really get back to the original purpose.

But I think just in concert and in response to your question, I believe that would be a step in the right direction. We need to know what really is taking place. And along that line I hope that Congress will give serious consideration to how it can work more directly with States and with other institutions in providing the kind of guarantees that allow banks in their area to be a little more influenced for the reasons of economic development.

I think that is an area that I would hope you can spend some time on, because I think there is a lot of promise in that to the

businesses. We can touch, we can reach out, and we can actually interact with someone who understands a problem because we are a factor in the community, because we are part of that community, and that is lot more doable in terms of capital because now you have got a champion working for you, and you have got someone who wants what you want in order to benefit that jurisdiction.

We do not have enough champions for minority businesses. We have a lot of obstacles but we do not have a lot of people to go to that say, yes, your win is my win and it is a win for the community.

And when we go to the politicians, and this is not a slap against politicians, but we have got to get those elements where we are all impacted by you not just us to a politician and then back, because then you start them versus us, and that gets to be a battle that small businesses do not have the resources to even fight, whether it is legally or administratively. We cannot fight because it is time away from doing what we should do, and so the bottom line is we still suffer.

Senator MOSELEY-BRAUN. Well, I just want to thank you. Again, I particularly thank you for your message, and if you can continue with the gospel in the business community that you can do good and do well simultaneously then we all will benefit, because I think that really has to be the central message. This is not doing favors to anybody, this is doing something that is in our collective best interest.

Mr. SMITH. I believe in civil rights. I have always believed in it and will never be negative towards civil rights and human rights. But it cannot dictate the whole agenda, and we found too many instances quite frankly where if someone uses a certain nomenclature to refer to another person and it is demeaning there are all kinds of reactions. There are demonstrations. You know, I remember the whole case with Marge Schott and the Cincinnati Reds. And everybody came out because of how she referred to minorities.

And having come from Cincinnati I told the people in Cincinnati, you really missed the boat. While she was apologizing you should have gotten a $10 million economic development program to train minorities. [Laughter.]

Mr. SMITH. And not just get an apology because an apology does not translate to economics. So, I think we suffer when we allow so much attention and so much in our own community to be dominated by the civil rights agenda because it literally takes the attention away from the real problem.

If a minority business, if an African-American business goes out of business which employs 50 people in that community, you do not hear a word and that is the real loss. And we have got to translate this energy from that of, I am angry because of what you called me, to that I need the productivity to be viable in the community where that unemployment is.

Senator MOSELEY-BRAUN. And it is in your interest to help cure that unemployment as much as it is mine.

Mr. SMITH. That is right. Thank you.

The CHAIRMAN. That is an excellent illustration on which to end this hearing. And I appreciate, Mr. Smith, the efforts you have taken to be with us this afternoon with your really excellent testi-

mony. We will probably be calling on you to return one of these days in the not too distant future.

Mr. SMITH. I would be glad to, sir.

The CHAIRMAN. Thank you again.

[Whereupon, at 4:35 p.m., the hearing was adjourned.]

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

DEPUTY ADMINISTRATOR

July 28, 1994

The Honorable Dale Bumpers
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

I am writing to clarify and expand upon information you learned at the hearing you chaired on Wednesday regarding the Small Business Administration's (SBA) Minority Small Business and Capital Ownership Development (MSBCOD) program, sometimes referred to as the 8(a) Program.

In Administrator Bowles' testimony before the House Small Business Committee in September of last year, he acknowledged that the problems in the Program were more extensive than the General Accounting Office (GAO) report indicated. In reality, the problems were more extensive than even the Administrator knew at that time. We were under the impression that there were close to 500-600 applications in our backlog; the actual number was closer to 1,000 applications.

Although we brought in experienced staff from field processing units on several occasions, we were unable to work through the backlog. As a result, in April of this year we changed the entire management of the Program. We now have in place a seasoned and highly regarded management team with experience in both procurement and minority enterprise development. Most importantly, **not only have we cleared up the backlog, but we are also processing applications in less than the statutorily mandated 90 days!**

As part of our overhaul of the Program, we have expanded the Program to provide comprehensive business and procurement training, changed the name to the Minority Enterprise Development (MED) Program to reflect its new emphasis, and created a separate department to combine the MED Program with Government Contracting to enable us to address some of the issues raised in previous audits.

One of the criticisms that has consistently been leveled at the Program is that too few companies benefit. That is absolutely true, and it is one of the primary issues we addressed in our new Program. In our discussions with 8(a) companies around the country and from the surveys we conducted, it was clear to us that one of the primary reasons this has occurred is that there were too many 8(a) certified companies which were neither able to obtain government contracts nor able to perform them successfully.

To address this problem, we are doing the following:

1. Establishing a program, in conjunction with our resource partners and sister agencies, to provide the necessary business and procurement training for the companies before they are certified;

2. Reviewing our portfolio of certified companies and offering to those companies which have been in the Program less than three (3) years, and have received no contracts, the opportunity to suspend their term of participation and return to intensive business and procurement training; and,

3. Eliminating the local buy/national buy restriction which has caused a disproportionate number of contracts to be concentrated among a few firms.

Another criticism of the Program has been that few, if any, companies are "graduated" from the Program when their net worth exceeds the limit. Again, this is absolutely true. During our evaluation of the Program, we discovered that a large number of our Business Development Specialists (BDS) are not trained in financial analysis and therefore do not know how to analyze financial statements. Moreover, they are overloaded with burdensome reports required by the Program, but which are not necessary for the efficient, effective management of the Program.

To address this problem, we are training our people in financial analysis, requiring our MED staff to take the same finance courses that our finance staff are required to take. We are also eliminating some of the burdensome reporting requirements so that our people can work with our customers, not with paper. A final change is that we are proposing to delegate contracting authority back to the procuring agencies. In our brainstorming sessions held all over the country that included 8(a) firms, bankers, procuring agencies and Congressional staff, it was universally agreed that there is no logical reason for the SBA to be a party to the contract. Certainly, we should be available to assist either party, but the contract should be between the supplier and the buyer. Not only will staff who are now involved in contracting be available to work directly with the companies and more closely monitor their progress, but it will also reduce the time that current BDS's are spending on contracting.

A final complaint by GAO was that SBA has failed to implement its Management Information System (MIS). During our evaluation, we took a serious look at the status of efforts to develop a MIS system. We were most disappointed at the minimal progress that had been made to date, and that was part of the management change that we made. We then got our Office of Information Management Resources more directly involved in the process of evaluating the Agency's needs and the progress of efforts to date. We decided to suspend the development of the MIS system until we completed our "reinvention" efforts, as we did not want to invest in a system that might be made obsolete by a new program.

Recent enhancements in the Agency's information infrastructure will enable us to use our existing system for data collection and purchase off-the-shelf automation tools to extract MED information, minimizing the expensive and time-consuming process of developing

customized software. We are also exploring the possibility of working with the Office of Federal Procurement Policy to collect more contract data. This approach is more cost-effective, reduces development time, and promotes consistency in reporting of government-wide procurement information. Our automation plan, including the budget and implementation schedule, will be finalized by August 30, 1994.

Some of the problems in the 8(a) Program are created by the procuring agencies themselves; for example, very large contracts which are beyond the capability of 8(a) firms and require excessive subcontracting are put into the Program. This results in 8(a) contracts being performed primarily by large, majority owned companies. By combining our MED Program with our Government Contracting program and developing aggressive goals for the procuring agencies that require not just dollar amounts of 8(a) contracts, but **numbers of contracts** and **numbers of contractors**, as well, we can attack this problem.

Mr. Chairman, let me assure you that the Administrator and I are aware of the problems in the 8(a) Program and have devoted a considerable amount of time, energy, and resources to correct these problems. As much as I would like to say that the problems are all fixed, I cannot. These problems did not appear suddenly, nor will they suddenly disappear.

It is unfortunate that so much energy is spent on the Program's negatives, for there are many positive elements to the MED Program. Not only do we have an excellent staff in place, but we are correcting many of the problems. In spite of these problems, the Program has produced successful companies which create jobs, pay taxes, and contribute to the economic growth and development of America. Thirty-two (32) of the top 100 African American owned businesses (*Black Enterprise Magazine*, June 1994) and 17 of the Top 100 Hispanic companies (*Hispanic Business Magazine*, June 1994) are or were in the 8(a) Program.

I would welcome the opportunity to tell you more about our proposed changes and to introduce you to some of the successful companies that used the Program for what it was intended to be, a tool to assist those who are denied access by leveling the playing field so that they can become full participants in our society. We look forward to testifying before your committee at your convenience to explain the Administration's proposed changes to this program.

Thank you for your continued support and assistance and your interest in, and commitment to, the small business men and women of America.

Sincerely,

Cassandra M. Pulley
Deputy Administrator

cc: Senator Larry Pressler
Senator John Kerry
Senator John Chafee

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